

# **The Performance Implications of Outward Foreign Direct Investment for Chinese Firms**

by

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## **Abstract**

The internationalisation of Chinese firms has attracted attention worldwide although most of Chinese MNEs are still in their early stage of internationalisation. Chinese firms' internationalisation has unique characteristics due to their home country's unique political environment, culture and economic structure. This thesis aims to investigate the implications of both of short-term stock market performance and long-term operating performance of outward foreign direct investment (OFDI) by Chinese firms.

Drawing on signalling theory and the institution-based view, the thesis firstly examines the extent of stock market reactions to the announcement of cross-border merger and acquisition (M&A) deals from a financial perspective, based on an event study of a sample of Chinese firms during the period 2000-2012. The findings indicate that Chinese firms' cross-border M&As result in a positive stock market reaction. The shareholders of Chinese firms that acquire a target firm in a host country with a low level of political risk gain higher cumulative abnormal returns than those firms targeting companies in countries with a high level of political risk. However, the shareholders of Chinese state-owned enterprises experience lower abnormal returns compared with those of Chinese privately owned firms when engaging in cross-border M&A deals.

The thesis further examines the impact of M&As on Chinese firms' post-acquisition operating performance by integrating organisational learning theory with the institution-based view. The findings indicate that firms with serial cross-border M&As achieve better performance than those engaged in first-time cross-border M&As, and

those with horizontal M&As perform better than those carrying out vertical M&As. The positive effects of acquisition experience and horizontal acquisitions on the post-acquisition performance of Chinese acquiring firms are reinforced by the institutional quality and language similarity of host countries.

Finally, this thesis investigates from a management perspective how Chinese MNEs adopt different management strategies (e.g. expatriates and subsidiary autonomy) to respond to environmental challenges and improve the performance of overseas subsidiaries. Drawing on the resource dependence theory, this thesis examines the indirect effects of expatriates on subsidiary performance via subsidiary autonomy based on a survey sample of Chinese MNEs. The findings show that an increase in expatriates reduces the level of subsidiary autonomy and thus negatively affects subsidiary performance. This study also finds that the institutional quality of host countries reinforces the negative impact of expatriates on subsidiary autonomy, but reduces the importance of the latter on subsidiary performance.

# **Dedication**

*To my family: Parents, husband, and son*

*With all my love and gratitude*

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# List of Publications

## Accepted Journal Publications

Tao, F, Liu, X, Gao, L, Xia, E (2016) Do cross-border mergers and acquisitions increase short-term market performance? The case of Chinese firms, *International Business Review*, 26(1), pp.189-202, ISSN: 1873-6149.

Tao, F, Liu, X, Gao, L, Xia, E (2016) Expatriates, Subsidiary Autonomy and the Overseas Subsidiary Performance of Chinese MNEs, *The International Journal of Human Resource Management*, Forthcoming.

## Conference Papers

Tao, F, Liu, X, Gao, L, Stock Market Reaction to Cross-border Mergers and Acquisitions by Chinese Firms: the Performance Implication of M&As, *41th The Academy of International Business UK & Ireland Conference (AIB UK & Ireland 2014)*, Main Track, The York Management School, 10-12 April 2014.

Tao, F, Factors Affecting the Performance of Cross-border Mergers and Acquisitions by Chinese Companies: Background, Motivations and Methodologies, *40<sup>th</sup> The Academy of International Business UK & Ireland Conference (AIB UK & Ireland 2013)*, Doctoral Colloquium, Aston Business School, 21-23 March 2013.

## Acronym List

AIIB	Asian Infrastructure Investment Bank
AMC	American Multi-Cinema
APFC	The Asia Pacific Foundation of Canada
AR	Abnormal Return
BEA	The Bank of East Asia
CARs	Cumulative Abnormal Returns
CBMAs	Cross-border Mergers and Acquisitions
CC	Control of Corruption
CCPIT	China Council for the Promotion of International Trade
CIP	The Centre for Integrated Photonics Ltd
CSMAR	China Stock Market & Accounting Research Database
EBIT	Earnings Before Interest and Taxes
EE	Emerging Economy
EMNEs	Emerging Multinational Enterprises
FDI	Foreign Direct Investment
GE	Government Effectiveness
GMM	Generalized Method of Moment
HCN	Host-Country National
HRM	Human Resource Management
IB	International Business
IBM	International Business Machines Corporation
ICBC	Industrial and Commercial Bank of China

M&As	Mergers and Acquisitions
MNEs	Multinational Enterprises
MOFCOM	Ministry of Commerce People's Republic of China
OECD	Organization for Economic Co-operation and Development
OFDI	Outward Foreign Direct Investment
OLI	Ownership Location Internalisation
OLS	Ordinary Least Square
PCN	Parent-Country National
PS	Political Stability and absence of violence
QFII	Qualified Foreign Institutional Investor
R&D	Research and Development
RDT	Resource Dependence Theory
RL	Rule of Law
ROA	Return on Asset
RQ	Regulatory Quality
SOEs	State-Owned Enterprises
SIC	Standard Industrial Classification
TCE	Transaction-Cost Economics
UNCTAD	United Nations Conference on Trade and Development
VA	Voice and Accountability
VIF	Variance Inflation Factor
WGI	World Governance Indicators
WIR	World Investment Report
WTO	World Trade Organization

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# **1. Introduction**

## **1.1 Research Context**

In the past, outward foreign direct investment (FDI) tended to be utilised by firms from developed countries to penetrate other countries' markets. In recent years, outward FDI has been gradually adopted by Emerging Economy (EE) MNEs for their internationalization (Wright, et al., 2005). According to the *World Investment Report* (2015), EEs accounted for more than one third of global outward FDI flows (35%) in 2014, up from 13% in 2007. Among them, China is playing an increasingly important role in global outward FDI activities as the largest EE in the world. Accompanying this rapid growth of the Chinese economy, China's outward FDI took off in the 2000s as a result of the government's adoption and promotion of the 'Go Out Policy', aiming to help domestic companies expand internationally to explore and exploit opportunities in international markets. China has been chosen as the research context of the thesis due to the rapid growth of Chinese outward FDI, with an average annual growth of almost 50% (WIR, 2014). China's outward FDI was only \$12 billion in 2005, but reached \$87.8 billion in 2012, which accounted for approximately 61% of outbound FDI from emerging economies. China's outward FDI overtook inward FDI in 2014 making China a net capital exporter for the first time. The new 'One Belt One Road' strategy announced in September 2013, the establishment of the Asian Infrastructure Investment Bank (AIIB) and the Silk Road fund will continue to promote large scale outward investment. According to the *World Investment Report 2015* (UNCTAD, 2015), China

has significantly strengthened its outward FDI with its outward FDI net flow increasing by 14.2% compared to the previous year, up to \$123.12 billion. Mainland China has been ranked 3<sup>rd</sup> among all countries (regions) in terms of outward FDI flows, and 8<sup>th</sup> in terms of stock, compared to 11<sup>th</sup> in the previous year. According to the Ministry of Commerce of China, China's non-financial outward FDI reached \$29.92 billion in January-February 2016, up 71.8% on the previous year. Table 1.1 presents China's outward FDI annual flow and stock data. These aspects indicate that China serves as an appropriate and important empirical setting where we can examine the factors affecting Chinese MNEs' overseas operations. Thus, it is timely to study the performance implications of China's outward FDI.

**Table 1.1 China's annual outward FDI flows and stock**

Year	(Billions of USD)				
	Flows			Stock	
	Amount	Global Ranking	Year-on-Year Growth Rate (%)	Amount	Global Ranking
2002	2.70	26		29.90	25
2003	2.90	21	5.6	33.20	25
2004	5.50	20	93.0	44.80	27
2005	12.26	17	122.9	57.20	24
2006	21.16	13	43.8	90.63	23
2007	26.51	17	25.3	117.91	22
2008	55.91	12	110.9	183.97	18
2009	56.53	5	1.1	245.75	16
2010	68.81	5	21.7	317.21	17
2011	74.65	6	8.5	424.78	13
2012	87.80	3	17.6	531.94	13
2013	107.84	3	22.8	660.48	11
2014	123.12	3	14.2	882.64	8

*Note:* 1. Data about China's outward FDI are based on MOFCOM statistics.

2. Data for 2002-2005 includes only non-financial outward FDI, and data for 2006-2012 includes outward FDI in all industries.

3. Annual growth rate for 2006 refers to that of non-financial outward FDI.



Among the different modes of engaging in outward FDI activities, including overseas sales, contractual agreements, strategic alliances, greenfield investment and cross-border Mergers and Acquisitions (M&As), cross-border M&As have taken place at a rapid pace during the last few years and have become by far the biggest means of international expansion (Aybar & Ficici, 2009; Boateng, Wang, & Yang, 2008; Chen & Young, 2010; Deng, 2009). Chinese firms have been actively involved in cross-border M&As in the past decades. The number of completed cross-border M&As by Chinese firms was only 33 and the total value of these deals was 838.86 million dollars in 2000, whereas in 2015 the number of completed deals increased to 346 and their value reached 55.1 billion dollars (Thomas One Banker 2016). Chinese firms have attracted attention worldwide with a series of high-profile cross-border M&As of well-known western companies, including ChemChina's acquisition of Syngenta (2016), Lenovo's acquisition of the Motorola mobility division (2014) and IBM's x86 Server Division (2015) and PC division (2005), Geely's acquisition of Volvo Corporation (2010), Wanda's acquisition of Odeon (2016), Sunseeker (2013) and the AMC Cinema chain (2012), and Huawei's acquisition of Symantec (2011) and CIP (2012). No wonder that Economist (2010) has noted that 'China buys up the world!'

## **1.2 Research Rationale**

As the increasing importance of outward FDI by Chinese firms and the rapid pace of such internationalisation activities by Chinese firms, which appear to be accelerating, further study needs to carry out on the performance implications of outward FDI of Chinese firms (Du & Boateng, 2015; Li, Cui, & Lu, 2014; Liu, Lu, & Chizema, 2014;

Sun, et al., 2015; Zhong, Peng, & Liu, 2013). As emerging multinational enterprises (EMNEs) arise from national, cultural and institutional contexts that are different from those of Western MNEs, classic theories on cross-border mergers and acquisitions may not be directly applied to analyse internationalisation activities by EMNEs. Moreover, unlike other emerging economies (like India, Russia, and Brazil), Chinese firms' outward FDI have unique characteristics due to their unique political environments, cultural background and economic structure (Tao, et al., 2016). Therefore, this thesis focuses on the performance implications of outward FDI by Chinese firms.

A growing number of studies are emerging examining the short-term performance of cross-border M&As by emerging-economy MNEs (Buckley, Elia, & Kafouros, 2014; Deng & Yang, 2015; Lebedev, et al., 2015; Ning, et al., 2014; Sun, et al., 2012). Some of these studies (Bhagat, Malhotra, & Zhu, 2011; Boateng, Wang, & Yang, 2008; Wang & Boateng, 2007; Zhou, et al., 2015) found a positive market reaction to cross-border M&As, while others (Aybar & Ficici, 2009; Chen & Young, 2010) found a negative one. The inconsistent findings of the existing studies suggest that stock market reactions to cross-border M&As by Chinese firms need further academic scrutiny. In addition, these existing studies have tended to assume that there are the same market reactions between stock markets in mainland China and Hong Kong. However, under the formula of 'one country, two systems' (China.org.cn, 2008), the Hong Kong stock market is different from the Shanghai and Shenzhen stock markets in mainland China. The different institutional arrangements between the two markets within one country may trigger different market reactions to the announcement of cross-border M&As by

Chinese firms. This unique ‘one country, two markets’ scenario remains underexplored in the domain of cross-border M&As.

Moreover, there is a lack of research studies investigating whether the level of political risk of target countries and the ownership status of acquiring firms will result in different market reactions to cross-border M&A activities by Chinese firms. The stock market is sensitive to any political risk associated with cross-border M&As, which is considered as an important signal, especially in emerging economies (Chan & Wei, 1996; Kim & Mei, 2001; Wang, Liu, & Wang, 2004). However, existing studies have tended to focus on the impact of geographic and cultural distance on cross-border M&As (Chakrabarti & Mitchell, 2013; Ragozzino, 2009) without explicitly taking political risks into account. *To remedy the research gap in short-term implications on stock market performance, this thesis aims to reveal the extent of market reactions to the institutional characteristics associated with cross-border M&A deals by Chinese listed firms.*

While an increasing number of studies on the performance of cross-border M&As focus on short-term stock market performance immediately surrounding announcement dates (Chakrabarti, Gupta-Mukherjee, & Jayaraman, 2009; Goergen & Renneboog, 2004; Gubbi, et al., 2010; Ning, et al., 2014), limited studies have investigated the long-term post-acquisition operating performance of acquiring firms, most of which have focused on M&As undertaken by firms from developed countries (Ghosh, 2001; Kruse, et al., 2007; Martynova, Oosting, & Renneboog, 2007; Pazarskis, et al., 2006; Sharma & Ho, 2002), with a few exceptions addressing EEs such as Russia (Bertrand & Betschinger,

2012), India (Kumar & Bansal, 2008; Mantravadi & Reddy, 2008) and Malaysia (Rahman & Limmack, 2004). However, unlike developed countries or other EEs, Chinese firms' cross-border mergers and acquisitions have unique characteristics due to their unique institutional environments, language spoken and economic structure.

Only a few studies focus on the post-acquisition operating performance of cross-border M&As by Chinese firms and the results are mixed. Wang (2006) has found negative post-acquisition operating performance while Bhabra and Huang (2013) found no change in operating performance from the pre to the post acquisition period for acquiring firms. The limited research carried out, with inconsistent findings suggests the importance of further research on long-term post-acquisition operating performance of cross-border M&As by Chinese firms under the special institutional environment in China. In addition, the existing studies (Bhabra & Huang, 2013; Wang, 2006) only empirically evaluated the operating performance of cross-border M&As in general without investigating the influence of a wide range of internal factors and the external institutional environment on the post-acquisition operating performance. *To remedy this research gap in the long-term implications on operating performance, this thesis is going to reveal the extent of the impact of a host country's institutional quality on the organisational learning of tacit knowledge in cross-border M&As as well as the impact of language barriers that could impede communication and information exchange during the organisational learning process.*

In addition to the financial perspective discussed above, the performance of Chinese firms' outward FDI can be tackled from a management perspective by investigating

how Chinese MNEs respond to overseas challenges using different management strategies to improve the performance of overseas subsidiaries. Over past decades, the influence of expatriates on subsidiary performance has been an important theme in the international business research (Colakoglu & Caligiuri, 2008; Gaur, Delios, & Singh, 2007; Gong, 2003a). However, existing studies on this areas focused on the direct impact of expatriation on subsidiary performance without considering the mediation role of subsidiary autonomy (Benito, et al., 2005; Colakoglu & Caligiuri, 2008; Tan & Mahoney, 2006; Xu, Pan, & Beamish, 2004). The mediating role of subsidiary autonomy in subsidiary performance has been under-explored, especially in the case of EMNEs.

Moreover, EMNEs have heavily invested in both developed economies and developing economies with varying institutional qualities. When institutions in host-countries are underdeveloped, in order to cope with increasing external uncertainty and decreasing social credibility (Agarwal & Ramaswami, 1992; Akhter & Lusch, 1998; Delios & Bjorkman, 2000; Henisz, 2000), EMNEs may alter the internal control system (e.g. expatriate staffing and subsidiary autonomy) to respond to the institutional environments of host countries. However, we know very little about the impact of internal control mechanisms such as expatriation staffing on subsidiary performance and whether such an impact is contingent on the institutional environment of host countries. *To remedy this research gap in overseas subsidiary performance, this thesis is going to examine the link between expatriates, subsidiary autonomy and subsidiary performance in the different institutional environments of host countries.*

## 1.3 Research Questions

This PhD project aims to help bridge the above three research gaps by investigating the performance of internationalised Chinese firms from both financial and management perspectives. This thesis intends to answer the following three research questions:

*Q1: What is the short-term impact of cross-border mergers and acquisitions on stock market performance by Chinese acquiring firms? How does the impact vary with host countries' political risk and acquiring firms' ownership status?*

*Q2: What is the long-term impact of cross-border mergers and acquisitions on operating performance by Chinese acquiring firms?*

*Q3: How do Chinese MNEs use different levels of expatriation and subsidiary autonomy as internal control mechanisms to improve the performance of overseas subsidiaries given the host countries' institutional conditions?*

The first two research questions focus on under which conditions cross-border M&A deals improve or hurt the financial performance of Chinese acquiring firms. Both the short-term impact on stock market performance and long-term impact on firms' post-acquisition operating performance are evaluated in this PhD thesis. Further to the investigation regarding the factors affecting financial performance of Chinese firms, the third research question focuses on how Chinese MNEs respond to the performance challenges by using different levels of expatriates and subsidiary autonomy as internal

control mechanisms to improve the performance of overseas subsidiaries, given different host countries' institutional conditions.

## **1.4 Intended Contributions**

Building upon the existing research, the author intends to make a number of potential contributions by answering the three research questions.

To address research question Q1, the author intends to extend the literature on cross-border M&As in general and EE firms in particular. The findings from the thesis will provide new insights into different market reactions to the same cross-border M&A events within one country, two markets. In particular, by examining the impact of political risk in host countries and the ownership status of acquiring firms on the short-term market performance of cross-border M&As, the study captures how the different institutional dimensions, such as political risk in the country of origin of target firms and ownership status, influence the market reactions of such activities. Thus, the findings enrich our understanding of performance implications of cross-border M&As by Chinese firms by showing under what conditions cross-border M&As create value for Chinese acquirers.

To address research question Q2, the author builds on organisational learning and the institution-based view and proposed that the long-term post-acquisition operating performance of Chinese acquiring firms is influenced by a variety of internal and external factors at the firm, industry and country levels. In doing so, this study adds to

the existing literature on M&A value creation from an emerging market MNEs' perspective by focusing on the role of cross-border M&As in the long-term operating performance of Chinese acquiring firms. More specifically, the author identifies the important moderating role of host-country institutional quality on the relationship between acquirers' experience and the target firms' industrial capabilities on the post-acquisition performance of EMNE firms. The findings shed new light on institutional conditions under which an acquirer's experience and the relative industrial capabilities affect an acquiring firms' performance and add much needed empirical evidence regarding the interrelationship between different types of acquisitions and EMNE performance. In addition, the author introduces the Chinese language, an important but underexplored informal institutional component in the learning literature, as a boundary condition of the organisational learning logic of M&As. By examining the moderating effects of the Chinese language, this study offers new insights on the importance of language ability in post-acquisition integration and synergy.

To address research question Q3, the author adopts the Resource Dependence Theory (RDT) to study the impact of the subsidiary control strategies adopted by Chinese MNEs that have heavily invested in both developed countries and developing countries with various degrees of institutional quality. The findings provide new insights on the mediating mechanism of subsidiary autonomy and fill the research gap in which previous studies have mainly focused on the direct impact of expatriation on subsidiary performance without considering the mediation role of subsidiary autonomy. The author also extends the existing research by examining the moderating role of host-



country institutional quality on the relationship between expatriates and subsidiary performance. The findings add much needed empirical evidence regarding the interrelationship between internal control mechanisms and EMNEs' overseas performance and advance existing research by capturing the complex linkage between EMNE parents and their subsidiaries through expatriates and subsidiary autonomy.

## **1.5 The Structure of the Thesis**

This section outlines the structure of this thesis and explains the content and purpose of each chapter. The thesis contains five chapters. The main body of the thesis consists of three chapters.

Drawing on the signalling theory and institution-based view, Chapter 2 examines the extent of market reactions to the announcement of cross-border M&A deals. The author examines whether different institutional characteristics (i.e. different capital market, political risk and ownership structure) generate different market reactions and result in different short-term market performance of cross-border M&As.

In Chapter 3, the influence of internal factors and external factors on the post-M&A operating performance of Chinese MNEs have been investigated at the firm, industry and country level by combining organisational learning and the institution-based view. The dynamic panel data model is applied to evaluate the impact of cross-border M&As on the post-acquisition operating performance of Chinese acquiring firms.

Chapter 4 examines the indirect effects of expatriate staffing on overseas subsidiary performance via subsidiary autonomy, drawing on the resource dependence theory. The author investigates what extent subsidiary autonomy mediates the impact of expatriate staffing on subsidiary performance and how institutional quality of host countries moderates the relationship between expatriate staffing and the subsidiary performance of EMNEs.

Chapter 5 concludes the whole thesis by summarising the key findings and research outcomes of the previous chapters, discussing contributions and acknowledging the research limitations. This chapter also puts forward implications of the study for managers and policy makers, as well as making suggestions for possible future research.

## **2. Short-term Implications of Cross-border M&As on Stock Market Performance**

### **2.1 Introduction**

In this chapter, the author addresses the first research question raised in Chapter 1 – “What is the short-term impact of cross-border mergers and acquisitions on stock market performance of Chinese acquiring firms?”

Despite the rapid pace and increasing importance of cross-border M&As by Chinese firms, existing research has predominantly focused on M&As undertaken by firms from developed countries (Ghosh, 2001; Kruse, et al., 2007; Martynova & Renneboog, 2008; Pazarskis, et al., 2006; Sharma & Ho, 2002). Only recently, an increasing number of studies have been emerging to investigate cross-border M&As by emerging-economy companies (Buckley, Elia, & Kafouros, 2014; Deng & Yang, 2015; Lebedev, et al., 2015; Ning, et al., 2014; Sun, et al., 2012). However, the research findings are mixed. Some research (Bhagat, Malhotra, & Zhu, 2011; Boateng, Wang, & Yang, 2008; Wang & Boateng, 2007; Zhou, et al., 2015) found a positive market reaction to cross-border M&As, while negative implications have been identified by others (Aybar & Ficici, 2009; Chen & Young, 2010). The contradictory research findings suggest that stock market reactions to cross-border M&As by Chinese firms remain unclear and further academic scrutiny will be needed.

In addition, without considering the differences of stock markets in mainland China and Hong Kong, the existing research has tended to assume that there are the same market reactions across the markets in Hong Kong and mainland China. In contrast, the Hong Kong stock market is different from those in mainland China under the formula of ‘one country, two systems’ (China.org.cn, 2008). In this thesis, the author called this unique scenario the ‘one country, two markets’ scenario, which demonstrates the unique institutional setting of China’s stock markets. Due to the different institutional arrangements between the two market types in China, including ownership restrictions, currency controls and liquidity restrictions, different market reactions may be triggered by the announcement of cross-border M&As by Chinese firms. This unique ‘one country, two markets’ scenario remains underexplored in the domain of cross-border M&As.

The stock market is sensitive to the political risk associated with cross-border M&As. As an important institutional factor, political risk may spur different market reactions to cross-border M&A deals. However, the impact of political risk in target countries has not been considered by existing studies on cross-border M&As by Chinese firms. Existing studies tend to focus on the impact of geographic and cultural distance on cross-border M&As (Chakrabarti & Mitchell, 2013; Ragozzino, 2009) without explicitly taking political risk into account. A recent study by Harzing & Pudelko (2016) has shown that cultural distance is often used as a proxy for political risk and government restrictions in a host country, and calls for more studies that use more appropriate and accurate constructs to measure host country characteristics, such as

political risk. In addition to political risk, we have a limited understanding of how the ownership status of Chinese acquiring firms affects investors' perceptions, and hence stock market reactions to different types of Chinese firms' cross-border M&As.

To remedy these research gaps, the author examines the following research questions. What are the stock market reactions to cross-border M&A announcements by Chinese firms? Do investors in the Hong Kong stock market respond differently to cross-border M&As by Chinese firms compared with those in the Shanghai and Shenzhen stock markets in mainland China? To what extent does political risk in the country of origin of the target firms, and the ownership status of the acquiring firms, affect the short-term stock market performance of Chinese firms with cross-border M&As?

To address these research questions, the author builds the study on signalling theory and the institution-based view to propose that the short-term market performance of Chinese acquiring firms is influenced by a variety of factors, including the different institutional settings within China, the political risk of target countries and the ownership status of the acquiring firms. Signalling theory is used to underpin stock market reactions to cross-border M&As while the institution-based view is adopted to reveal what is behind investors' perceptions in stock markets. In contrast to existing studies which investigate the direct relationship between cross-border M&As and firm performance, this chapter intends to capture stock market reactions based on signalling theory, and unpack how stock markets react to cross-border M&As by Chinese listed firms. More specifically, the author aims to reveal the extent of market reactions to the

institutional characteristics associated with cross-border M&A deals by Chinese listed firms using an event-study method.

The chapter is organised as follows: Section 2.2 reviews the existing studies on short-term performance of cross-border M&As, followed by the theoretical foundations. In section 2.4, a number of hypotheses are developed based on the signalling theory and institution-based views. The author describes the sample and methodology used in the study in Section 2.5. The results are discussed in Section 2.6, while Section 2.7 discusses findings, followed by the conclusions.

## **2.2 Literature Review**

A cross-border M&A could be interpreted as an indication of a substantial change in a firm's corporate strategy. Stock market investors will react to this change through buying or selling stocks according to their perception of the firm's future performance, which constitutes the stock market reaction. The terms 'stock market reaction' and 'investors' reactions' are interchangeable. Existing research on stock market reactions to cross-border M&As can be classified into two broad categories according to the country of origin of the acquiring firms – developed economies or emerging economies, which will be discussed in this section.

Considerable research has been devoted to the impact of cross-border M&As on the short-term shareholder values of acquiring firms from developed economies (Asquith, 1983; Faccio, McConnell, & Stolin, 2006; Firth, 1980; Masulis, Wang, & Xie, 2007;

Mitchell & Stafford, 2000; Schwert, 2000). However, the empirical evidence is mixed. For example, the extant studies conducted by Asquith (1983), Morck et al. (1990), Lang et al. (1991), Schwert (2000), Floreani and Rigamonti (2001), Moeller et al. (2005), Faccio et al. (2006) and Masulis et al. (2007) find positive abnormal returns for the shareholders of US acquiring firms. In contrast, Langetieg (1978) provides a contrary view, indicating that US acquiring firms earn significant negative abnormal returns over the six months before and the twelve months after the merger date, which are similar to those reported in more recent studies (Mitchell & Stafford, 2000; Sudarsanam, Holl, & Salami, 1996; Walker, 2000). Bruner (2002) suggests that in aggregate, abnormal returns to shareholders of US acquiring firms are essentially zero.

Positive abnormal returns have been reported for many other developed markets, such as Japan (Kang, Shivdasani, & Yamada, 2000; Pettway & Yamada, 1986), Canada (Eckbo & Thorburn, 2009) and several European countries, including France, Germany, Netherlands, Portugal (Faccio, McConnell, & Stolin, 2006; Goergen & Renneboog, 2004; Martynova & Renneboog, 2008). Furthermore, Ben-Amar and Andre (2006) provide evidence that shareholders of acquiring firms earned positive returns between the periods 1998-2000 based on a sample of mergers and acquisitions by the Canadian firms. On the contrary, Sudarsanam and Mahate (2003) examine a sample of 519 UK acquirers over the period 1983 to 1995 and find negative abnormal returns relative to the month of the merger announcement, with only a third of acquirers experiencing wealth gains. Campa and Hernando (2004) also look at a sample of mergers and acquisitions within Europe, reporting that international mergers destroy shareholder

value, especially in regulated industries. The main reason is that the existence of a strong regulatory framework creates a difficult environment that hampers the potential success of an acquisition.

Due to the increasing number of cross-border M&As by EE firms, comprehensive studies need to be undertaken to further examine the impact of cross-border M&As by these firms. Zhu and Malhotra (2008) find evidence of positive gains for the short-term shareholders of Indian acquiring firms. Likewise, using a sample of 425 cross-border acquisitions by Indian firms, Gubbi et al. (2010) show that the shareholders of acquiring firms earned positive abnormal returns from 2000 to 2007. A similar study of 8 emerging countries by Bhagat et al. (2011) based on a sample of 678 firms over the 1991-2008 period reports that cross-border M&As earn positive returns for acquiring firms. However, Aybar and Ficici (2009) examine 433 cross-border acquisitions associated with 58 emerging-market multinationals between the years 1991-2004 and show that shareholders of acquiring firms earn negative abnormal returns. Table 2.1 provides a summary of previous research on the stock market performance of cross-border M&As.

The review of the literature shows that existing studies have either focused on a direct link between M&A deals and stock market reactions without providing a theoretical underpinning for such reactions (Ben-Amar & Andre, 2006; Faccio, McConnell, & Stolin, 2006; Floreani & Rigamonti, 2001; Gubbi, et al., 2010), or adopted the resource-based view (Gubbi, et al., 2010; Ning, et al., 2014) and agency theory (Chen & Young, 2010) to examine the impact of internal factors on stock market performance. For



example, Faccio, McConnell, and Stolin (2006) investigate the relationship between ownership structure and the announcement period of abnormal returns to acquirers of listed and unlisted targets in 17 Western European countries, during the period between 1996 and 2001, without providing a theoretical foundation. They find no significant impact of ownership structure on abnormal returns. Based on the resource-based view, Gubbi et al. (2010) examine 425 cross-border M&As by Indian firms during 2000-2007 to investigate whether acquiring firms can create value for their shareholders in cross-border M&A deals. They argue that firms from emerging economies use the form of cross-border M&As as a vehicle to acquire strategic assets in various markets to overcome their latecomer and foreignness disadvantages so as to enhance their competitive advantage. Based on agency theory, Chen and Young (2010) use a sample of 39 cross-border M&As involving 32 Chinese firms from 2000 to 2008 and find that overseas acquisitions destroy acquiring firms' shareholders value, because Chinese investors themselves have little confidence in these MNE's ability to effectively manage their acquisitions.

In summary, a large portion of the existing studies on the performance of cross-border M&As only focuses on the extent to which cross-border M&As influence the acquiring and target firms' performance without explicitly investigating the effect of political risk in the country of origin of the target firms and different institutional settings of stock markets in mainland China. There is a strong need to carry out an in-depth investigation of the effect of institutional factors on the stock market performance of cross-border M&As by Chinese firms. In addressing this, a series of institutional factors will be

evaluated in the following sections in the context of China's special institutional environment by combining signalling theory and the institution-based view.

**Table 2.1 A summary of existing studies on the link between cross-border M&As and stock market performance**

Market	Author(s), (year)	Sample period	Details of Sample	Findings
Panel A: Developed markets				
US	Dodd (1980)	1970-1977	151 takeovers	-0.23% cumulative abnormal return on the announcement date from completed bids
US	Bradley et al. (1983)	1962-1980	241 successful deals, 94 unsuccessful deals	-0.64% insignificant returns for the unsuccessful bidders over -20 and +20 days period
US	Lang et al. (1989)	1968-1986	87 targets and bidders from successful tender offers	Negative impact on bidder returns when the bid is made by a firm with a low Tobin's $q$
US	Smith and Kim (1994)	1980-1986	177 bidders and targets	0.23% significant abnormal returns over -1 and 0 days
US	Floreani and Rigamonti (2001)	1996-2000	56 listed acquirers	3.65% abnormal returns obtained by insurance companies
US	Song and Walking (2004)	1985-2001	5726 mergers and acquisitions	Acquiring firms with a period of more than one year of 'dormant' bid activity receive a positive abnormal return of 0.8%. Acquirers with a 'dormant' period of less than one year earn insignificant returns

US	Faccio et al. (2006)	1996-2001	4429 acquirers of listed and unlisted targets	-0.38% significant abnormal returns for acquirers of unlisted targets, while 1.48% significant abnormal returns for acquirers of listed targets
US	Masulis et al. (2007)	1990-2003	3333 completed acquisitions	Acquires operating in more competitive industries or separating the positions of CEO and chairman of the board experience higher abnormal announcement returns
UK	Holl and Kyriazis (1997)	1979-1989	178 successful bids	-1.25% significantly negative abnormal returns for bidders over the two months after the bid announcement
UK	Sudarsanam and Mahate (2003)	1983-1995	519 listed acquirers	between -1.39% and -1.47% significantly negative abnormal returns for UK acquirers
UK	Conn et al., (2005)	1984-1998	4344 acquisitions	Significantly positive announcement returns for bidders when the culture difference is great between UK bidders firms and foreign target firms
UK	Gregory and McCorrison (2005)	1985-1994	343 acquisitions	Short-run returns are insignificantly different from zero irrespective of the location of the acquisition
EU	Campa and Hernando (2004)	1998-2000	262 mergers and acquisitions	-1.96% negative abnormal returns for regulated EU acquirers over 60 days around the bid announcement. No significant returns for bidders from unregulated industries for the same period

EU	Goergen and Renneboog (2004)	1993-2000	187 bidders	1.2% significantly cumulative abnormal returns for bidders over 5 days around the announcement date
EU	Chari et al. (2010)	1986-2006	594 acquisitions in emerging markets and 1624 acquisitions in developed markets	1.16% significantly positive abnormal returns for developed-market acquirers over a three-day event window
Canada	Ben-Amar and Andre (2006)	1998-2000	238 mergers and acquisitions by 138 Canadian firms	1.6% abnormal returns for acquiring firms over 3 days
Canada	Dutta et al. (2013)	1993-2002	1300 completed acquisitions	Significantly positive abnormal returns for Canadian acquiring firms' shares around the announcement date

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Panel B: Emerging market

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India	Gubbi et al. (2010)	2000-2007	425 cross-border acquisitions by Indian firms	International acquisitions by Indian firms earn significantly positive value for their shareholders
India and China	Nicholson and Salaber (2013)	2000-2010	203 Indian and 63 Chinese cross-border deals	Cross-border acquisitions made by Indian and Chinese firms lead to significant shareholder wealth creation. Indian shareholders are more likely to benefit from deals in small culture distance

countries, while Chinese investors gain from the cross-border expansion of manufacturing companies

China	Chen and Young (2010)	2000-2008	39 deals by 32 Chinese MNEs	Negative average cumulated abnormal returns for Chinese acquiring MNEs
China	Ning et al. (2014)	1991-2010	335 acquisitions	Significant positive shareholder value for Chinese acquiring MNEs
Emerging market	Aybar and Ficici (2009)	1991-2004	433 acquisitions by 58 emerging-market multinationals	The equity markets react negatively to the emerging market cross-border acquisition announcement
Emerging market	Bhagat et al. (2011)	1991-2008	698 acquisitions by publicly listed firms from eight emerging countries	Emerging country acquirers experience a positive and significant market response of 1.09% on the announcement day

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## **2.3 Theoretical Foundation**

Departing from existing research, the author combines signalling theory and the institution-based view to capture market reactions to cross-border M&As by Chinese firms by taking account of the impact of various institutional factors.

### **2.3.1 Signalling Theory and Cross-border M&As**

Signalling theory is based on the assumption that information is not equally available to all parties at the same time and the theory is fundamentally concerned with reducing information asymmetry between different parties (Spence, 2002). This theory helps to explain how decision-makers interpret and respond to situations where information is both incomplete and asymmetrically distributed among parties (Spence, 1973; 1974). It includes three primary elements: signallers, receivers and the signal itself. Signallers are insiders (e.g. managers or executives) who obtain information about individuals (Spence, 1973), products (Kirmani & Rao, 2000) and organisations (Ross, 1977). This information is not available to outsiders. Receivers are outsiders who lack information about the organisation but would like to receive this information. Due to information asymmetries, outsiders (e.g. investors) cannot obtain adequate information to accurately assess a firm's true value.

Signalling theory is built on the premise that an internal party, such as an acquirer, possesses special information while external parties, such as investors, may not be able to access such information and may need to rely on other sources of information (Arrow, 1968; 1973; 1959; Arrow & Debreu, 1954; Grossman & Hart, 1981; Nelson, 1970).

This theory has been used in a variety of management literatures, including strategic management (Ozmel, Reuer, & Gulati, 2013; Priem, Li, & Carr, 2012; Reuer & Ragozzino, 2012), entrepreneurship (Ahlers, et al., 2015; Bergh, et al., 2014; Moss, Neubaum, & Meyskens, 2015) and human resource management (Lourenço, et al., 2014; Renwick, Redman, & Maguire, 2012).

The author adopts signalling theory to predict whether and how investors would react to the announcement of cross-border M&As through buying and selling shares in the stock market. The announcement of cross-border M&As serves as a signal sent by acquiring firms and can influence the expectations of investors. If there is strong confidence in the management of the acquiring firm, and the information about the M&A transaction is explicit, it should be reflected in the stock market reaction. If the announcement of a cross-border M&A is interpreted by investors as an optimistic belief in the future, this should cause an increase in the stock price. It is also true where the announcement of cross-border M&As is perceived negatively by investors, resulting in a decrease in stock prices.

### **2.3.2 Institution-based View and Cross-border M&As**

While signalling theory can help capture stock market reactions to cross-border M&A deals, it is insufficient in revealing what is behind such reactions towards M&A deals. Therefore, the signalling theory needs to be integrated with other theories in order to unpack stock market reactions to show what is behind such reactions. The institution-based view has been widely used as a pivotal theoretical lens in international business



(Buckley, et al., 2007; North, 1990; Peng, 2002; Peng, Wang, & Jiang, 2008; Wan & Hoskisson, 2003; Wright, et al., 2005). Institutions have long been identified as a key factor affecting cross-border M&A performance (Peng, Wang, & Jiang, 2008; Wan & Hoskisson, 2003), given that cross-border M&A activities are subject to institutional constraints. Home and host-country institutions exert significant influence on the completion rates of cross-border M&A deals, and affect the integration and success of post cross-border M&As (Gubbi, et al., 2010; Zhang, Zhou, & Ebbers, 2011). Due to unique institutional settings of Chinese economy and unique institutional environments of Chinese society, institutional factors play an even more important role influencing the market reactions to cross-border M&As by Chinese firms. For example, a large portion of Chinese acquirers are state-owned enterprises; many cross-border M&As by Chinese firms are state-sponsored or state-supported; the settings of mainland stock markets are significantly different from the stock markets in the rest of world including the Hong Kong stock market. Therefore, the author integrates the signalling theory with the institution-based view to unpack what lies behind stock market reactions to the announcement of cross-border M&As.

The institution-based view has emerged as an important paradigm, and posits that institutions in a society influence firm strategy and performance (Buckley, et al., 2007; North, 1990; Peng, Wang, & Jiang, 2008). North (1990) defines institutions as the ‘rule of the game’ in a society. Similarly, Scott (1995) specified that institutions are ‘regulative, normative and cognitive structures and activities that provide stability and meaning to social behaviour’.

The institution-based view as a widely adopted theoretical lens in IB research is also implicitly reflected in Dunning's Ownership Location Internationalisation (OLI) paradigm. In more recent studies, Dunning and Lundan (2008) and Cantwell, Dunning and Lundan (2010) have explicitly proposed that institutional factors affecting both the determinants and the outcomes of MNE activity can be incorporated into the OLI paradigm. Building on the analysis of North (1990), Dunning and Lundan (2008) show the direct link between host-country institutional environments and the location-based (L) advantages in the OLI paradigm. The institutionally related location advantages differ between developed and developing countries. Specifically, well-established institutions help firms to reduce uncertainty and risk, and facilitate knowledge acquisition (Lu, et al., 2014; Schwens, Eiche, & Kabst, 2011; Uhlenbruck, et al., 2006). The host country government can enhance its country's location advantages by improving its institutions in order to attract foreign firms (Guler & Guillen, 2010; Witt & Lewin, 2007). Thus, the institutional environment in a host country has important implications for MNEs' internationalisation outcomes (Chung & Beamish, 2005; Cui & Jiang, 2012; Gao, Liu, & Lioliou, 2015; Holmes, et al., 2013; Kostova, Roth, & Dacin, 2008; Pangarkar & Lim, 2003; Wang, et al., 2012).

In the case of cross-border M&As, when assessing a firm's value and evaluating its future performance to make investment decisions, investors perceive institutional information as an important signal, especially when they are unable to obtain adequate firm-specific information due to information asymmetries. The difference in regulations on financial markets may lead to different market reactions to the same

M&A events. Thus, the author expects that market reactions to cross-border M&A events in the Hong Kong stock market may differ from those in mainland Chinese stock markets. Moreover, when Chinese firms acquire firms from countries with different levels of political risk, which constitutes a major aspect of the institutional environment, stock market investors will interpret and respond to such cross-border M&As differently. Firms with a different ownership status, such as State Owned Enterprises (SOEs) or privately owned firms, may also generate different stock market reactions, resulting in differing performance, given that SOEs can be perceived as a major element of Chinese economic institutions.

## **2.4 Hypotheses Development**

Based on the theory and evidence discussed above, the author develops here several hypotheses related to factors affecting the short-term stock market performance of acquiring firms involved in cross-border M&As.

### **2.4.1 Market Reactions**

The announcement of cross-border M&As by Chinese firms may release a strong signal to the market, according to signalling theory. However, cross-border M&As are still a newly emerging activity for Chinese firms and Chinese investors. As a result, many Chinese firms involved in cross-border M&As are ‘first-time buyers’ who have not been involved in any cross-border M&As previously. Cross-border M&As by Chinese firms are typically interpreted as a very strong signal released by the top management of Chinese acquirers, indicating their ambitions and confidence in the global market

(Gubbi, et al., 2010). Thus, the announcement of cross-border M&As by Chinese firms is likely to be perceived positively by stock market investors.

In addition, the announcement of cross-border M&As by Chinese firms may indicate Chinese firms' engagement in seeking strategic assets in order to enhance their performance and catch up with global giants (Deng, 2007). M&As are used as an important approach through which Chinese firms obtain resources and capabilities that are not available in the domestic market (Deng, 2007; Rui & Yip, 2008). These resources, including natural resources, patent-protected technologies, well-known brands, as well as superior managerial and marketing skills (Athreya & Kapur, 2009; Chen, 2008; Rui & Yip, 2008), can be converted into competitive advantages in the post-acquisition period. Thus, investors may perceive that cross-border M&As serve as a strategic means of addressing resource and capability deficits, and overcoming domestic market constraints. Moreover, firms can better exploit their existing resources and competitive advantages in new markets to realise economies of scale (Li, Li, & Wang, 2016). Therefore, cross-border M&As will be perceived to enhance the competitive advantages of Chinese firms by integrating the acquired resources and capabilities from overseas. Ultimately, investors will expect cross-border M&As to create shareholder value due to improved competitive advantage and firm performance.

Finally, the Chinese government has promoted and encouraged Chinese firms to invest abroad with the 'go abroad' policy since 1999 (Luo, Xue, & Han, 2010). The support from the Chinese government in the form of tax deductions, low-interest loans and investment treaties with other governments has helped Chinese companies to deal with

host-country governments and institutions (Luo, Xue, & Han, 2010). The Chinese government's political and financial support is interpreted as a positive signal and thus leads to a positive market reaction.

It should be noted that cross-border M&A announcements may negatively affect the market and hence lead to a decrease in stock prices (Aybar & Ficici, 2009). However, growing fast and being big has become a widely accepted strategy among Chinese firms and this strategy is supported by the Chinese government (Chen & Shih, 2008). In this regard, Chinese firms are likely to create positive market expectations due to the potential benefits associated with cross-border M&A deals. Hence, cross-border M&As are more likely to generate positive stock market reactions in China (Gaur, Delios, & Singh, 2007).

In summary, for Chinese firms, cross-border M&As may also represent a unique and important strategic means of value creation, given that these activities enable Chinese firms to obtain critical resources and capabilities and help them overcome domestic institutional constraints in developing these critical resources, thus raising their profile in the eye of investors. These firms may also create positive market expectations, due to the various benefits associated with cross-border M&A deals. This can result in positive stock market reactions in general which in turn affect the market performance of those firms involved in cross-border M&A activities. Therefore, we propose:

**Hypothesis 1a:** The announcement of cross-border M&As by Chinese firms results in a positive stock market reaction.

While the author hypothesises that cross-border M&As by Chinese firms will generate positive market reactions, it is necessary to differentiate market reactions in mainland Chinese stock markets with the Hong Kong stock market, given the unique institutional settings of ‘one country, two systems’. There may be asymmetric market reactions to the same news in the two types of stock markets across China. The different market reactions in stock markets across China can be shown in the stock market prices and the magnitude of future volatility of return.

Under the formula ‘one country, two systems’, the Hong Kong stock market is significantly different from the Shanghai and Shenzhen stock market in mainland China. Good-news-chasing behaviour by investors has been observed in mainland China, but to a lesser degree in the Hong Kong stock market and stock markets in the developed world (Wang, Liu, & Wang, 2004). This good-news-chasing behaviour means that the impact of good news (positive unexpected shock) on future volatility is larger than that of bad news (negative unexpected shock) of the same magnitude (Yeh & Lee, 2000) and could lead to different market reactions to cross-border M&A activities by Chinese firms. The good-news-chasing behaviour of investors in mainland China could be explained by the unique institutional features of stock markets in China. In mainland China, the liquidity of shares traded in the Shanghai and Shenzhen stock markets is limited compared to those in the Hong Kong market, due to significant constraints on the tradability of state shares and legal-person shares (Yeung & Huang, 2014). Given the huge amount of ‘hot’ money flowing around mainland China stock markets, limited

liquidity of share trading will aggregate the market reactions to the announcement of cross-border M&As.

Furthermore, there is a lack of institutional investors, especially experienced international institutional investors in the Shanghai and Shenzhen stock markets due to institutional restrictions. Most shares traded in the Shanghai and Shenzhen stock markets are domestic shares that are generally restricted to domestic investors (Wang & Jiang, 2004). Foreign investment is only allowed through a tightly-regulated structure known as the Qualified Foreign Institutional Investor (QFII) System. In mainland China, the turnover is overwhelmingly a result of actions by individual domestic retail investors. According to the Shanghai Stock Exchange Statistical Yearbook (2014), the retail investors in this market contributed 82.24% of total market turnover value which is considerably higher than the Hong Kong stock market (only 25%). A huge number of retail investors in the mainland Chinese stock markets, called ‘noise traders’, are relatively inexperienced in trading and they may respond more positively than others to the announcement of cross-border M&As because they have no access to inside information and so they can, at times, behave irrationally (Black, 1986). Driven by the lack of other investment options in less-established Chinese capital markets, and institutional restrictions, retail investors in mainland China are more proactive in the stock markets than those in any other main stock markets. Those irrationally optimistic retail investors in mainland China may react differently from experienced overseas institutional investors in the Hong Kong stock market to the announcement of cross-border M&As. Accordingly, we proposed that:

**Hypothesis 1b:** The positive stock market reaction is stronger in the mainland Chinese stock markets than in the Hong Kong stock market.

In discussing the market reactions to cross-border M&As by Chinese firms, the author further considers the extent to which the stock market performance of M&As is influenced by institutional characteristics associated with cross-border M&As. Specifically, the author assesses the extent of market reactions to political risks in the target firms' country of origin and the ownership status of acquiring firms. In doing so, the author aims to capture the political dimension of the institutional environment of the target firms' country of origin, and different types of acquiring firms.

#### **2.4.2 Political Risk: Stability and Governance Quality**

Political risk constitutes an important aspect of institutional environments and is closely connected to the way institutions function in a country (Bilson, Brailsford, & Hooper, 2002). It refers to the degree of political stability within a country, the quality of the laws, regulations, administrative procedures and policies formally sanctioned by the government (Cuervo-Cazurra, 2008; 2006; Delios & Henisz, 2003). Host countries with different levels of political risk may have different performance implications with regard to cross-border M&As, which in turn can affect market reactions. In this study, the author considers two important dimensions of political risk, namely political stability and governance quality.

##### ***Political Stability***



There are a number of reasons why the political stability of a target firm's country of origin can affect market reactions to cross-border M&As. Firstly, the level of political stability may affect investors' risk perception, and thus lead to different market reactions (Bekaert, et al., 2014; Pástor & Veronesi, 2013; 2012). Since institutions are developed to create order and stable environments, and so promote economic exchange and cooperation (North, 1990; Williamson, 1985), host countries with high political stability imply low uncertainty and pose low risk to business activities. On the contrary, host countries with low political stability pose a serious challenge to the success of cross-border M&As (Cao & Liu, 2013). Foreign firms in particular can be more vulnerable targets during conflict due to their status of being outsiders (Hutchison & Gibler, 2007). For example, Chinese firms have heavily invested in Africa, the Middle East and Latin America in recent years, but civil wars and regional conflicts due to political instability represent big threats to the safety of investment in these regions. In particular, the Libyan civil war in 2011 caused over \$18 billion of loss to 75 Chinese firms (New.cn, 2011). This implies that the stock market may react negatively to cross-border M&As if companies seek to acquire firms in countries with a high level of political instability, since they may suffer heavy losses in the future.

Secondly, uncertainty associated with sudden policy changes poses further challenges to firms (Bekaert, et al., 2014; Pástor & Veronesi, 2013; 2012). It is evident that Chinese firms have encountered U-turns in governmental policy towards foreign investments in some African countries when there has been a change of regime (Gao, Liu, & Lioliou,

2015). Therefore, future M&As in similar countries may send out negative signals to investors due to the uncertainty.

Thirdly, a low level of political stability is likely to have an impact on post-acquisition activities and hinder the acquirer's efforts to establish and enforce cooperative agreements with local partners (Brouthers & Hennart, 2007; Feinberg & Gupta, 2009), thus leading to higher transaction costs when the company tries to acquire and integrate local resources. With uncertainty and high transaction costs, the acquired companies may find it hard to generate positive financial returns to pay dividends or create shareholder value, which will in turn be perceived as a negative signal by the stock market. Therefore, we propose:

**Hypothesis 2a:** The shareholders of Chinese firms that have acquired firms from countries with a high level of political stability gain higher cumulative abnormal returns than those that have acquired firms from countries with a low level of political stability.

### ***Governance quality***

The governance quality of the host country government and its agencies plays an essential role in the success of MNEs' operations in such countries (Bekaert, et al., 2014; Berry, 2006; Pástor & Veronesi, 2013). Specifically, well-established rules and regulations help Chinese MNEs reduce the regulatory ambiguity associated with cross-border investments (Gao, Liu, & Lioliou, 2015). Thus, acquiring firms are able to

reduce information search costs and shorten the learning curve associated with foreign operations when investing in countries with clear rules and regulations (Uhlenbruck, et al., 2006). Consequently, firms can devote their time and resources to post-acquisition integration and improved performance.

In addition, the level of bribery and corruption in the host country government can also have an impact on firms investing in these countries. Corrupt practices in host countries where target companies originate not only represent legal and reputational risks, but also influence the financial viability of cross-border M&A deals (Uhlenbruck, et al., 2006). If a target company derives a proportion of its revenues through corrupt means, this can have a significant impact on the future cash flow of the firm when the acquiring company puts a stop to such corrupt practices (Clifford, 2012). Therefore, M&A deals in countries with a high level of corruption may send out negative signals to investors.

Furthermore, advanced knowledge and resources are more likely to be learned and obtained from developed countries with a higher level of governance quality where more institutional protection is provided for foreign direct investment (Berry, 2006). It is widely recognized that Chinese firms tend to seek high quality knowledge and resources through cross-border M&As, which has been identified as one of the two motivations of Chinese M&A deals alongside knowledge exploitation (Deng, 2007; Wang & Boateng, 2007; Zheng, et al., 2016). Chinese MNEs that lack modern managerial expertise, international market knowledge and advanced technology may be able to acquire valuable knowledge and resources when target firms are from institutionally developed countries because these countries are more likely to possess

strategic resources needed by Chinese firms (Nicholson & Salaber, 2013). Chinese firms can obtain advanced knowledge and resources by acquiring target companies from developed countries with high governance quality and low political risk (Cui, Meryer, & Hu, 2014; Liu, et al., 2016). Combining these acquired strategic resources, including technological knowledge, market knowledge and managerial knowledge, with low-cost advantage, Chinese firms are able to gain a unique, competitive advantage in both international markets and over their competitors in China who are unable to obtain the same knowledge and resources in the domestic market, thus boosting firm performance (Deng, 2010). Accordingly, we proposed that:

**Hypothesis 2b:** The shareholders of Chinese firms that have acquired firms from countries with a high level of governance quality gain higher cumulative abnormal returns than those that have acquired firms from countries with a low level of governance quality.

#### **2.4.3 Ownership: SOE Acquirer vs. Private Acquirers**

Firms with different ownership status are associated with different capabilities and behave differently, depending on different institutional constraints and competitive pressures (Zhou & Witteloostuijn, 2010). Research suggests that SOEs not only represent an ownership structure or a form of corporate governance, but are also products of the institutional environment (Bruton, et al., 2015; Child & Rodrigues, 2005; Peng, 2000). This is particularly true in China where SOEs are an important instrument used by the government to control and coordinate economic activities (Bai, Lu, & Tao,

2006; Sun, Tong, & Tong, 2002; Tian & Estrin, 2008). This implies that SOEs can be perceived as a major element of economic institutions. Therefore, the ownership status of acquiring firms can affect the market performance of cross-border M&As by signalling different performance implications.

First, Chinese SOEs obtain preferential treatment from the government and a favourable allocation of resources, which in turn improve the value of the companies (Blanchard & Shleifer, 2001; Sun & Tong, 2003; Tian & Estrin, 2008). Therefore, the success of these companies often depends on their monopoly positions in the domestic market, rather than their managerial capabilities or the use of advanced technology (Wu & Xie, 2010; Zhang, Zhou, & Ebbers, 2011). Their performance may be adversely affected when SOEs are moving from the Chinese domestic market to the international market (Lin, 2010). It is argued that cross-border M&As could lead to a lower performance of SOEs due to the weak corporate governance associated with state ownership, as well as possible political interference (Ning, et al., 2014).

Unlike SOEs with a monopoly of government-controlled resources, private firms have to compete based on their technological and marketing capabilities in order to survive and prosper (Peng, 2001). Moreover, private firms tend to be more effective than SOEs in terms of market orientation and innovation (Peng, Wang, & Tong, 2004). In addition, many private firms have greater flexibility and autonomy in terms of management and decision making. This implies that private firms may be able to compete in foreign markets and integrate target firms more effectively than SOEs, thus leading to a higher level of performance (Liu, et al., 2016).

Moreover, existing research indicates that most SOEs are more interested in utilities and infrastructure industries, such as energy, telecommunication and transport (OECD, 2008). However, this may raise political and public concern in the host countries which they target, especially in developed countries (Cui & Jiang, 2012; Gao, Liu, & Lioliou, 2015). The natural association between state ownership and the Chinese government may increase political sensitivity and public concern (Globerman & Shapiro, 2009; Zhang, Zhou, & Ebbers, 2011), which may lead to a negative impact on the market performance of SOE acquirers due to possible political interference. Therefore, the announcement of cross-border M&A deals by firms with a different ownership status may send different signals to investors, which may result in different stock market reactions and post-acquisition performance. Hence, we propose

**Hypothesis 3:** The shareholders of Chinese SOE acquirers have lower cumulative abnormal returns from cross-border M&A deals than those of Chinese private acquirers.

## **2.5 Data and Methodology**

### **2.5.1 Sample and Data Collection**

The data on cross-border M&As by Chinese firms from January 2000 to December 2012 was obtained from the Thomason One Banker database. Due to the implementation of the ‘Go Global’ policy initiated in 1999 by the Chinese government, and China’s entry into the World Trade Organisation (WTO) in 2001, large-scale cross-border M&As by Chinese firms started from 2000 and this is why the year 2000 has

been selected as the starting point of our investigation. For M&A deals, the Thomson One Banker provides a comprehensive database for global M&As which is widely used for academic research. In this study, all M&A deal-related data has been sourced from this database, including the announcement date, the name of both acquirers and target firms, as well as the home country of these firms. A Chinese acquiring firm should meet all the following criteria in order to be included in the sample: (i) the M&A deals are listed as completed transactions; (ii) the firm has stock price data which is available on the Shanghai, Shenzhen or Hong Kong stock exchanges; (iii) the announcement date of M&A lies between January 1, 2000 and December 31, 2012; and (iv) the target companies lie outside mainland China. The final usable sample consists of 165 cross-border M&As by Chinese acquiring firms.

Table 2.2 provides an overview of the sample distribution in terms of the industry classification and ownership status of the acquiring firms, as well as the country of origin of foreign target firms. Most Chinese acquirers are located in the manufacturing industry (SIC 20-39) followed by the financial sector (SIC 60-67), which accounts for 58.79% and 12.12% of the total cross-border M&As respectively. For Chinese acquirers, Asia/Pacific firms were most frequently the target of cross-border acquisitions, and account for 49.09% of total cross-border M&As, followed by 23.03% of acquisitions in North America and 20.61% in Europe. In addition, 58.18% of cross-border M&A deals were conducted by Chinese privately owned firms.

**Table 2.2 Information on the sample firms**

	N	% of sample		N	% of sample
Acquirers' industry			Target Country		
SIC 10-14 Mining	19	12.00%	Europe	34	20.61%
SIC 20-39 Manufacturing	97	58.79%	Asia/Pacific	81	49.09%
SIC 40-49 Transportation and communications	7	4.24%	North America	38	23.03%
SCI 50-59 Wholesale and Retail	8	4.85%	Others	12	7.27%
SIC 60-67 Finance	20	12.12%	Total	165	
SIC 70-89 Services	14	8.48%			
Total	165				
Ownership status of acquirers					
State-owned	69	41.82%			
Private	96	58.18%			
Total	165				

## 2.5.2 Methodology

### *Measurements*

The author adopts the notion that stock market reactions to the announcement of cross-border M&As are reflected in the change of a listed firm's share price around the occurrence of the event (Gaur, Malhotra, & Zhu, 2013; Gubbi, et al., 2010) and thus the daily stock prices for acquiring firms around the announcement dates are used to measure the stock market performance of these firms. This measure has been widely used in international business and strategic management studies of M&As (Doukas &



Travlos, 1998; Halebian & Finkelstein, 1999; Moeller & Schlingemann, 2005). More specifically, the author uses Cumulative Abnormal Returns (CARs) to shareholders as a measure of short-term stock market performance. A company is classified as a SOE if the government has a majority ownership share.

Following previous studies (Gubbi, et al., 2010), we use the *World Governance Indicators* (WGI) compiled by Kaufman et al. (2010) to measure political risk. The WGI index constructs aggregate indicators of six dimensions of governance for 215 countries and territories from 1996 to 2012. These six items include Voice and Accountability (VA), Political Stability and absence of violence (PS), Government Effectiveness (GE), Regulatory Quality (RQ), Rule of Law (RL), and Control of Corruption (CC). The author uses the first two items to measure political stability and the rest to measure governance quality. Each of these six items have values that range from -2.5 to 2.5, with higher values reflecting lower political risk in the country of origin of respective target firms. Values  $\geq 0$  reflect lower levels of political risk, whereas those  $< 0$  indicate higher levels of such risk.

#### *Event study*

In order to investigate the impact of Chinese cross-border M&As on the stock-market performance of acquiring firms, the event study method is employed to calculate and analyse cumulative abnormal returns (Aybar & Ficici, 2009; Chari, Ouimet, & Tesar, 2010). This method is based on the assumption of immediate information processing by stock market participants (Fama, 1991) and can be used to determine whether there

is an abnormal effect on stock prices associated with unanticipated events, such as M&As.

Prior studies using the event study method indicate that investors use information about a firm's cross-border M&As to adjust expectations about its performance potential, as evidenced by changes in CARs upon the announcement of cross-border M&As. The event study method is widely used to capture market reactions to an announced event that was previously unexpected (McWilliams & Siegel, 1997).

In order to assess the stock price reaction to announcements of cross-border M&As, Abnormal Return (AR) is calculated based on a standard market model (Brown & Warner, 1985) which can be presented in the following equation.

$$AR_{it} = R_{it} - (\alpha_i + \beta_i R_{mt})$$

where  $AR_{it}$  is the abnormal return,  $R_{it}$  is the actual daily stock return for firm  $i$  on day  $t$ , and  $R_{mt}$  is the daily return from the Shanghai Stock Exchange Composite Index and Shenzhen Stock Exchange Composite Index and Hong Kong HangSheng Index on day  $t$ . The coefficients  $\alpha_i$  and  $\beta_i$  are OLS parameters estimated through the regression of  $R_{it}$  on  $R_{mt}$ .

To measure the stock market reactions to the announcement of cross-border M&As, the event window should be determined, which is the number of days over which there are possible ARs caused by the event. A very long window could dilute the possibility of

finding any significant evidence. A very short event window may not catch the effect of the event if the information comes out after the closing of the market and does not arrive in the public domain until the next day. Therefore, the author uses a 3-day, 5-day and 11-day event window to examine the stock market's short-term response to the merger and acquisition announcement (Aybar & Ficici, 2009; Bhabra & Huang, 2013). Furthermore, CARs are calculated by summing the average AR for the days of the event window:

$$CAR_t = \sum_{t=1}^n AR_t$$

where  $CAR_t$  is the CAR for the time period from  $t = \text{day 1}$  until  $t = \text{day } n$ .

To further assess whether the CAR is caused by the fluctuation of share prices, the statistical significance of the CARs is tested with the  $t$  statistic

$$t_{CAR} = \frac{CAR}{S_{CAR} / \sqrt{n}}$$

where  $S_{CAR}$  is the standard deviation of the cumulative abnormal returns. If the CAR observed during the announcement of Chinese cross-border M&As is significantly different from zero, it can be concluded that this event has a significant impact on the acquiring firms' stock prices.

## 2.6 Empirical Results

Table 2.3 presents the results of empirical analysis of the CARs of 165 cross-border M&As by Chinese listed firms surrounding the cross-border merger and acquisition announcement dates. Around the announcement date, CARs are consistently positive with values of 0.84%, 0.89% and 1.22% for the (-1, 0), (0, +1) and (-1, +1) windows, respectively. All of them are significant at the 1% and 5% level. The findings show that, on average, cross-border M&As by Chinese listed firms generated a positive market reaction by producing positive abnormal returns to the shareholdings of acquiring firms, thus supporting Hypothesis 1a.

**Table 2.3 Cumulative abnormal returns (CARs) for Chinese acquiring firms**

	N	Mean	s.d.	t-Stat	Positive: negative	% positive
CAR (-1, 0)	165	0.0084	0.0402	2.682***	92:73	55.76%
CAR (0, +1)	165	0.0089	0.0503	2.275**	86:79	52.12%
CAR (-1, +1)	165	0.0122	0.0539	2.902***	93:72	56.36%
CAR (-2, +2)	165	0.0050	0.0718	0.890	89:76	53.94%
CAR (-5, +5)	165	0.0093	0.0936	1.278	80:85	51.52%

\*p<0.1, \*\*p<0.05, \*\*\*p<0.01

Table 2.4 reports the empirical results of the cumulative abnormal returns based on acquiring firms listed in different stock markets. For those listed in the mainland market, the mean CARs range from 0.79% to 1.53% and are statistically significant for the period of (-1, 0), (0, 1) and (-1, +1) during the announcement date. On the contrary, for those listed in the Hong Kong market, the mean CARs range from -0.10% to 1.16%.

All of them are positive, but insignificant, except for the period of (-2, +2). This finding shows that the positive market reaction is more significant in the mainland stock markets than that in the Hong Kong market. Thus, these results support Hypothesis 1b.

**Table 2.4 Market reactions: Mainland China vs. Hong Kong**

Event window	Mainland			Hong Kong		
	N	Mean CAR <sub>M</sub>	t-Stat	N	Mean CAR <sub>H</sub>	t-Stat
CAR (-1, 0)	103	0.0133	2.997***	62	0.0003	0.079
CAR (0, +1)	103	0.0104	2.372**	62	0.0064	0.851
CAR (-1, +1)	103	0.0153	2.992***	62	0.0070	0.964
CAR (-2, +2)	103	0.0086	1.334	62	-0.0010	-0.098
CAR (-5, +5)	103	0.0079	0.970	62	0.0116	0.834

\*p<0.1, \*\*p<0.05, \*\*\*p<0.01

As shown in Table 2.5-2.10, we investigate hypotheses 2a and 2b by testing the six governance indicators one by one to compare the effect of different levels of each indicator on stock market performance. The findings show that for the shareholders of Chinese acquiring firms who have acquired the target firms from countries with a low level of political stability (e.g. VA and PS) and governance quality (e.g. GE, RQ, RL and CC), all of the CARs are insignificant. These indicate that the shareholders of Chinese acquiring firms who purchase target firms from such a country have not generated substantial positive announcement gains. Conversely, for the shareholders of the Chinese acquiring firms who purchase target firms from a country with a high level of political stability and governance quality, the CARs for (-1, 0), (0, +1) and (-1, +1)

are all positive and statistically significant. These indicate that the announcement of cross-border M&As for target firms from such a country have yielded highly significant wealth for the shareholders of acquiring firms surrounding the announcement date. The difference between the abnormal returns of acquiring firms that purchase target firms from countries with different level of political stability and governance quality is illustrated in Tables 2.5-2.10. The results show that all the shareholders of acquiring firms that purchase target firms from a country with a high level of political stability and governance quality earn higher returns than those targeting firms from a country with a low level of political stability and governance quality. These further demonstrate that a high level of political stability and governance quality is perceived positively and this results in a high level of stock market performance. Taken together, the empirical evidence supports Hypothesis 2a and Hypothesis 2b.

**Table 2.5 VA: High VA vs. Low VA**

Event window	Low VA			High VA		
	N	Mean CAR <sub>L</sub>	t-Stat	N	Mean CAR <sub>H</sub>	t-Stat
CAR (-1, 0)	22	-0.0034	-0.381	143	0.0093	2.833***
CAR (0, +1)	22	0.0008	0.077	143	0.0095	2.304**
CAR (-1, +1)	22	0.0005	0.052	143	0.0131	2.934***
CAR (-2, +2)	22	-0.0025	-0.172	143	0.0056	0.939
CAR (-5, +5)	22	-0.0099	-0.435	143	0.0108	1.414

Note: VA=Voice and Accountability

\*p<0.1, \*\*p<0.05, \*\*\*p<0.01

**Table 2.6 PS: High PS vs. Low PS**

Event window	Low PS			High PS		
	N	Mean CAR <sub>L</sub>	t-Stat	N	Mean CAR <sub>H</sub>	t-Stat
CAR (-1, 0)	16	0.0056	0.888	149	0.0087	2.559**
CAR (0, +1)	16	0.0124	1.806*	149	0.0085	1.995**
CAR (-1, +1)	16	0.0080	1.048	149	0.0126	2.758***
CAR (-2, +2)	16	0.0076	0.817	149	0.0047	0.768
CAR (-5, +5)	16	0.0237	1.300	149	0.0078	0.993

Note: PS=Political Stability and Absence of Violence

\*p<0.1, \*\*p<0.05, \*\*\*p<0.01

**Table 2.7 PS: High GE vs. Low GE**

Event window	Low GE			High GE		
	N	Mean CAR <sub>L</sub>	t-Stat	N	Mean CAR <sub>H</sub>	t-Stat
CAR (-1, 0)	25	-0.0038	-0.511	140	0.0096	2.870***
CAR (0, +1)	25	0.0141	1.691	140	0.0084	1.983**
CAR (-1, +1)	25	0.0062	0.655	140	0.0128	2.824***
CAR (-2, +2)	25	-0.0018	-0.121	140	0.0056	0.944
CAR (-5, +5)	25	0.0263	1.372	140	0.0076	0.979

Note: GE=Government Effectiveness

\*p<0.1, \*\*p<0.05, \*\*\*p<0.01

**Table 2.8 RQ: High RQ vs. Low RQ**

Event window	Low RQ			High RQ		
	N	Mean CAR <sub>L</sub>	t-Stat	N	Mean CAR <sub>H</sub>	t-Stat
CAR (-1, 0)	13	0.0016	0.158	152	0.0090	2.728***
CAR (0, +1)	13	0.0124	1.293	152	0.0086	2.062**
CAR (-1, +1)	13	0.0093	0.913	152	0.0124	2.774***
CAR (-2, +2)	13	-0.0018	-0.116	152	0.0056	0.939
CAR (-5, +5)	13	0.0362	1.807*	152	0.0070	0.910

Note: RQ=Regulator Quality

\*p<0.1, \*\*p<0.05, \*\*\*p<0.01

**Table 2.9 High RL vs. Low RL**

Event window	Low RL			High RL		
	N	Mean CAR <sub>L</sub>	t-Stat	N	Mean CAR <sub>H</sub>	t-Stat
CAR (-1, 0)	19	0.0004	0.066	146	0.0094	2.757***
CAR (0, +1)	19	0.0108	1.591	146	0.0087	1.996**
CAR (-1, +1)	19	0.0057	0.756	146	0.0130	2.804***
CAR (-2, +2)	19	-0.0005	-0.047	146	0.0057	0.926
CAR (-5, +5)	19	0.0170	1.087	146	0.0083	1.040

Note: RL=Rule of Law

\*p<0.1, \*\*p<0.05, \*\*\*p<0.01



**Table 2.10 CC: High CC vs. Low CC**

Event window	Low CC			High CC		
	N	Mean CAR <sub>L</sub>	t-Stat	N	Mean CAR <sub>H</sub>	t-Stat
CAR (-1, 0)	21	0.0019	0.309	144	0.0093	2.698***
CAR (0, +1)	21	0.0097	1.544	144	0.0088	1.999**
CAR (-1, +1)	21	0.0083	1.101	144	0.0128	2.719***
CAR (-2, +2)	21	0.0017	0.163	144	0.0054	0.876
CAR (-5, +5)	21	0.0197	1.323	144	0.0078	0.966

Note: CC=Control of Corruption

\*p<0.1, \*\*p<0.05, \*\*\*p<0.01

The results of testing the impact of the ownership status of Chinese acquiring firms are illustrated in Table 2.11. The results in Table 2.11 indicate that for SOE acquirers, the CARs for (-1, 0), (0, +1), (-1, +1) and (-5, +5) are positive, but statistically insignificant. This suggests that the shareholders of Chinese SOE acquirers did not experience substantial positive wealth gains. In comparison, for privately owned firms (acquirers), the CARs show positive returns for all event windows. For the event window (-1, 0), (0, +1) and (-1, +1), the shareholders of Chinese private firms experienced statistically significant positive CARs of 1.31%, 1.28% and 1.88%, respectively. These results indicate that the announcement of the cross-border M&As for private acquiring firms yielded highly significant wealth gain for their shareholders. The difference between the abnormal returns of the private acquirers and SOE acquirers is illustrated in Table 2.11. The results indicate that cross-border M&As created higher returns for the shareholders of Chinese private acquirers than those of Chinese SOE acquirers

surrounding the announcement date, except for the period of (-5, +5). Taken together, these findings are consistent with Hypothesis 3.

**Table 2.11 Ownership: SOE acquirer vs. private acquirers**

Event window	SOE			Private		
	N	Mean CAR <sub>S</sub>	t-Stat	N	Mean CAR <sub>P</sub>	t-Stat
CAR (-1, 0)	69	0.0019	0.582	96	0.0131	2.722***
CAR (0, +1)	69	0.0035	1.079	96	0.0128	2.03**
CAR (-1, +1)	69	0.0030	0.766	96	0.0188	2.852***
CAR (-2, +2)	69	-0.0037	-0.628	96	0.0112	1.298
CAR (-5, +5)	69	0.0146	1.572	96	0.0055	0.518

\*p<0.1, \*\*p<0.05, \*\*\*p<0.01

## 2.7 Discussion

Accompanying the rapid development of the Chinese economy since the open door policy and economic reforms over past decades, Chinese firms are playing an increasingly important role in cross-border M&A activities (Li, Li, & Wang, 2016; Zheng, et al., 2016). However, we have limited understanding of the performance implications of such activities. This chapter examines the stock market reaction to cross-border M&As by Chinese firms based on signalling theory and the institution-based view. The results indicate that cross-border M&As by Chinese firms are interpreted by the stock market as strong signals released by Chinese acquirers which result in a significant, positive stock market reaction. This implies that M&A activities

by Chinese firms symbolise these firms' global ambitions and financial status, and are perceived as a spring board to acquiring strategic resources and capabilities abroad in order to seize opportunities and enhance competitive advantage in the global market. Thus, the announcement of cross-border M&As is perceived positively and has resulted in an increase in stock prices through a positive stock market reaction.

The findings are consistent with the majority of previous studies (Bhagat, Malhotra, & Zhu, 2011; Boateng, Wang, & Yang, 2008; Wang & Boateng, 2007; Zhou, et al., 2015) on cross-border M&As by EE firms, but are contrary to Aybar and Ficici's study (2009) and Chen and Young's study (2010). Aybar and Ficici (2009) used a sample from 13 key emerging economies between 1991 and 2004, without including China. However, unlike other emerging economies (e.g. India, Russia, and Malaysia), Chinese firms' cross-border M&As have unique characteristics due to the unique institutional environment and may trigger different market reactions. This may be the main reason why our findings differ from those of Aybar and Ficici (2009). Chen and Young (2010) studied 39 deals by 32 Chinese firms from 2000 to 2008 and showed that the announcement of cross-border M&As resulted in negative average CARs for Chinese acquirers. Their results are based on a relatively small sample which also includes foreign-invested companies within mainland China as acquired/target firms. Their sample period from 2000 to 2008 represented an early stage of cross-border M&As by Chinese firms. These factors together may largely influence the empirical results and yield a different conclusion. The findings drawn from a sample period up to 2012 may

reflect the increasing importance of cross-border M&As in the short-term market performance of Chinese listed firms due to the strong market reactions.

The findings show that there are asymmetric market reactions to cross-border M&As by Chinese firms in mainland Chinese stock markets and the Hong Kong stock market. Different market reactions in these stock markets reflect the institutional arrangements of 'one country, two systems' across China. The mainland Chinese stock markets behave differently from the one in Hong Kong. The former exhibits good-news-chasing behaviour which generates more significant reactions to the same M&A events than those in the Hong Kong stock market. This suggests that the 'one country, two markets' scenario results in different magnitudes of market perceptions. Investors in mainland China suffer from significant information asymmetries and limited investment options due to the underdeveloped capital market and thus they are more likely to overestimate the positive impact of cross-border M&A deals compared with those in the Hong Kong stock market. This finding demonstrates that the impact of cross-border M&As is affected by financial institutional arrangements.

Furthermore, the author has evaluated the market performance implications of M&As in terms of the target firms' countries of origin, with different levels of political risk, and the ownership status of the acquiring firms (SOEs vs private firms) from the institutional perspective. Chinese cross-border M&As benefit from well-established institutions and a stable investment environment in target countries with a low level of political risk. These target countries may enable Chinese acquirers to access a high quality of strategic resources, technological knowledge and market knowledge which

are not available in the domestic market or in other emerging economies. Thus, the shareholders of acquiring firms that purchase a target firm from an institutionally developed country with a low level of political risk can gain higher returns than those shareholders of acquiring firms who invest in countries with a high level of political risk. Chinese firms use cross-border M&As to signal their quality, especially when targeting firms are from institutionally well-developed countries with a low level of political risk. This shows that cross-border M&As enable Chinese firms to span national boundaries to gain strategic assets and credibly enhance their global reputation (Siegel, 2009), thus generating positive market reactions. The findings are consistent with real-life events. For example, the announcement of ICBC's acquisition of Halim Bank Indonesia only resulted in a 0.54% increase in its share price in 2006. However, the announcement of ICBC's acquisition of BEA Canada resulted in a 4.15% increase in share price in 2011.

The results suggest that cross-border M&As have different performance implications for acquiring firms with different ownership status. More specifically, the shareholders of Chinese SOE acquirers experience lower CARs than those of Chinese private acquirers. The possible reason is that SOE acquirers face stronger institutional restrictions than private acquirers which may give a negative signal to investors, and this in turn is reflected in stock prices. The empirical results also reveal the hidden relationship between ownership status and the market performance of cross-border M&As. The shareholders of Chinese SOE acquirers earn a lower level of abnormal returns than those of private acquirers. This finding implies that SOEs, as both

economic and political actors, may carry the baggage embedded in the institutional environment of their home country, and investors may be sceptical about the political motivations of cross-border M&As by SOE acquirers, thus resulting in lower shareholder value.

## **2.8 Summary**

Adopting signalling theory and the institution-based view, this study examines how stock markets react to the announcement of cross-border M&As by Chinese listed firms and whether institutional characteristics associated with cross-border M&As generate different market reactions and result in different short-term market performance. An event study analysis based on a sample of Chinese listed firms from 2000 to 2012 finds that the stock market, on average, responded positively and significantly to cross-border M&A announcements. The magnitude of such a market reaction to cross-border M&A events is greater in the mainland Chinese stock markets than that of the Hong Kong stock market. This may indicate that the mainland China stock markets are underdeveloped and tend to overreact to cross-border M&A announcements due to ‘good-news-chasing’ behaviour and irrational trading. The author has further investigated the extent to which the political risk inherent in the target firms’ country of origin and the ownership status of acquiring firms affect stock market reactions. The findings show that the level of political risk and SOE ownership are negatively associated with the short-term market performance of Chinese acquiring firms. Taken together, the study helps provide new insights into the relationship between the short-

term market performance and the institutional characteristics associated with cross-border M&As by Chinese firms.

## **3. Long-term Implications of Cross-border M&As on Operating Performance**

### **3.1 Introduction**

In this chapter, the investigation of the long-term implications for the operating performance of Chinese firms is undertaken to address the second research question of the thesis – “What is the long-term impact of cross-border M&As on operating performance by Chinese acquiring firms?”

Cross-border M&As are increasingly adopted as an important corporate strategy that helps firms in their external growth and improves their competitive advantage (Aybar & Ficici, 2009; Boateng, Wang, & Yang, 2008; Danbolt & Maciver, 2012; Deng, 2010; 2010; Eije & Wiegerinck, 2010; Gregory & McCorriston, 2005; Rui & Yip, 2008). While most of the existing research on the performance implications of cross-border M&As focuses on short-term stock market performance immediately surrounding the announcement dates (Chakrabarti, Gupta-Mukherjee, & Jayaraman, 2009; Goergen & Renneboog, 2004; Gubbi, et al., 2010; Ning, et al., 2014), limited studies have addressed the post-acquisition operating performance of acquiring firms in the long run (Dutta & Jog, 2009; Martynova & Renneboog, 2008). Empirical evidence on these studies on long-term operating performance is mixed and inconclusive. While a few studies have reported the significant impact of cross-border M&As on the post-acquisition operating performance of the acquiring firms (Healy, Palepu, & Ruback, 1992; Kruse, et al., 2007; Powell & Stark, 2005), others have found non-significant or



negative operating performance (Dickerson, Gibson, & Euclid, 1997; Dutta & Jog, 2009; Ghosh, 2001; Martynova, Oosting, & Renneboog, 2007; Yeh & Hoshino, 2002).

Much existing research on the implications for an acquiring firm's post-acquisition operating performance has focused on M&As undertaken by firms from developed economies (Ghosh, 2001; Kruse, et al., 2007; Martynova, Oosting, & Renneboog, 2007; Pazarskis, et al., 2006; Sharma & Ho, 2002). With the increased importance of emerging economies in the global market, there is an increasing number of studies published recently looking at M&As undertaken by firms from emerging economies including India (Kumar & Bansal, 2008; Mantravadi & Reddy, 2008), Russia (Bertrand & Betschinger, 2012) and Malaysia (Rahman & Limmack, 2004). However, in contrast to developed countries or other emerging economies, Chinese firms' cross-border M&As have unique characteristics due to their unique institutional environments, language spoken and economic structure. The existing studies addressing the post-acquisition operating performance of cross-border M&As by Chinese firms are few, and the results are inconsistent. Wang (2006) found negative operating performance while Bhabra and Huang (2013) found that there is no change in the operating performance from the pre to the post acquisition period for acquirers. The limited research with inconsistent findings suggests the need for further research on the long-term post-acquisition operating performance of cross-border M&As by Chinese acquirers.

In addition, the existing studies (Bhabra & Huang, 2013; Wang, 2006) have empirically evaluated the overall operating performance of cross-border M&As without

investigating the moderating role of both formal and informal institutions. In order to remedy these research gaps, the author examines the following research questions: To what extent does an acquirers' experience and a targets' industrial relatedness influence the long-term post-acquisition operating performance of Chinese acquiring firms? To what extent do formal institutions (i.e. a host country's institutional quality) and informal institutions (i.e. sharing the same language) moderate the impact of experience and industrial relatedness on post-acquisition firm performance?

To address the research questions, the author builds this study on organisational learning and the institution-based view and proposes that the long-term post-acquisition operating performance of Chinese acquiring firms is influenced by a variety of internal and external factors at the firm, industry and country levels. Cross-border M&As facilitate the organisational learning process that is critical to gain competitive advantage for emerging Chinese MNEs, which could significantly impact their operating performance. In cross-border M&As, Chinese acquirers could not only learn from their own prior acquisition experience both in success and failure which will make their future cross-border M&A more successful, but also acquire a broader range of knowledge from peer target firms, especially within the same industry. While organisational learning is used to investigate the firm- and industry-level factors, the institution-based view is used to examine the country-level factors that can also influence the operating performance of cross-border M&As. More specifically, the author aims to reveal the extent of the impact of a host country's institutional quality on the organisational learning of tacit knowledge in cross-border M&As as well as the

impact of language barriers that could impede the communication and information exchange during the learning process.

The rest of this chapter is organised as follows: in section 3.2 reviews the long-term operating performance of cross-border M&As; section 3.3 introduces the theoretical foundations: organisational learning and institution-based view, followed by the hypotheses. The sample and methodology used in this study are described in Section 3.5. Section 3.6 discusses the empirical results. The findings are discussed in Section 3.7. Section 3.8 concludes the study.

## **3.2 Literature Review**

Existing research on the long-term implications of cross-border M&As for operating performance can be classified into two broad categories – the operating performance of acquiring firms from developed countries and the operating performance of acquiring firms from developing countries. Panel A in Table 3.1 summaries the literature on the operating performance of firms involved in mergers and acquisitions from developed countries, which yields different results depending on the sample and methodology used (Martynova & Renneboog, 2008). The greater number of studies investigating the operating performance of cross-border M&As are by US firms, which employ more complex techniques to measure changes in the post-acquisition performance and lead to mixed results. For example, Healy et al. (1992) examine the performance of the 50 largest acquisitions between 1979 and 1984 and find that cash flow performance improves following acquisitions. This is supported by more recent studies of Andrade

et al. (2001), Linn and Switzer (2001) and Heron and Lie (2002), which indicate improved operating performance. However, Ghosh (2001) argues that no evidence of improved operating performance improvement is found after acquisitions. Similarly, Moeller and Schlingemann (2004) select a sample of 4430 acquisitions between 1985 and 1996 and report no significant change in operating performance. In contrast, some studies document a significant decline in post-acquisition operating performance (Clark & Ofek, 1994; Hogarty, 1970).

The studies on the performance of cross-border M&As involving UK firms have drawn contradictory findings too. Some studies based on UK firms' acquisitions report a significant improvement in operating performance (Chatterjee & Meeks, 1996; Conn, et al., 2005; Manson, et al., 2000). Powell and Stark (2005) show that takeovers completed in UK firms over the period 1985 to 1993 lead to significant improvements in operating performance. In contrast, Dickerson et al (1997) find a significant decline in the post-acquisition performance. The findings of Meeks (1997) appear consistent with Dickerson et al. (1997) that there is a decrease in post-acquisition performance. Similar to the studies of the US and UK firms discussed above, the studies investigating other developed countries also yield contradictory results. Evidence suggests that Japanese M&As result in a decrease in post-acquisition operating performance of the merged firm (Kruse, et al., 2002; Yeh & Hoshino, 2002). However, Sharma and Ho (2002) argue that Australian M&As result in insignificant changes in the profitability of bidding and target firms after the takeover. Dutta and Jog (2009) do not find evidence of any systematic long-term deterioration in operating performance of Canadian

acquirers. For Continental European countries, Martynova et al. (2007) examine 155 European M&As completed during 1997-2001 and find that the profitability of the combined firm decreased significantly following the takeover. Likewise, Gugler et al. (2003) find a significant decline in post-acquisition sales of combined firms.

The literature on emerging markets (Panel B in Table 3.1) is scarce despite the fast growth of cross-border M&As from these countries. In line with developed-market studies, the findings from this stream of research are also inconsistent. For example, Kumar and Bansal (2008) conducted a study to analyse the impact of mergers and acquisitions on the operating performance of companies from emerging markets and show a significant improvement in the post-acquisition performance of acquirers. Rahman and Kimmack (2004) investigate the post-acquisition operating performance of acquiring firms based on a sample of 94 listed and 113 private Malaysian companies during 1988-1992. Their findings reveal that there is a significant improvement in the post-acquisition operating performance of acquirers. On the contrary, the impact of mergers and acquisitions on operating performance has been investigated by Mishra and Chandra (2010) during the period from 2000-2006 considering acquisitions in the Indian pharmaceutical industry. They conclude that mergers and acquisitions fail to improve the firm's performance following mergers. Mantravadi and Reddy (2008) investigate a sample of 118 cases of mergers and acquisitions to study the impact of mergers and acquisitions on the operating performance of acquirers during a period from 1999-2003. The results show that acquisitions are usually associated with a negative change in long-term operating performance.

There are two notable reasons underlying the inconsistent findings from this stream of work. First, these studies on long-term operating performance are based on different national contexts. Most of these studies based on US data conclude that the acquiring firm's experience has a significantly negative effect on operating performance for cross-border M&As (Agrawal, Jaffe, & Mandelker, 1992; Heron & Lie, 2002; Moeller & Schlingemann, 2004). Second, extant studies have exclusively examined the direct impact of various factors (i.e., payment methods, target size, or leverage) on post-acquisition performance without considering the external environment. It means that existing studies lack research on investigating the relationship between various factors and operating performance by taking institutional contexts into account.

The limited existing research with its inconsistent findings indicates the importance of this study on the post-acquisition operating performance of cross-border M&As. This research will focus on what factors determine the long-term operating performance of cross-border M&As by Chinese firms by considering both institutional and industry contexts in which both Chinese acquirers and target firms operate. More specifically, This chapter will address the research gap by examining under which conditions cross-border M&A deals improve or hurt the performance of Chinese acquiring firms. In addition to the short-term impact on stock market performance which has been evaluated in the previous chapter, the long-term impact of cross-border M&As on firms' post-acquisition operating performance will be evaluated in this chapter.

**Table 3.1 Overview of the empirical studies on post-acquisition operating performance**

Market	Author(s), (year)	Sample period	Sample size	Performance measure	Change (C) or Intercept (I) model	Determinants	Findings
Panel A: Developed countries							
US	Healy et al., (1992)	1979-1984	50	Pre-tax cash flow	C + I	Method of payment; industry relatedness; target size	<ol style="list-style-type: none"> <li>1. Merged firms have significant improvements in operating performance after the merger;</li> <li>2. The degree of industry overlapping has no impact on post-merger performance improvement;</li> <li>3. The method of financing the acquisition deal has no impact on post-merger operating performance</li> </ol>
US	Ghosh, (2001)	1981-1995	135	Pre-tax cash flow	C + I	Method of payment	<ol style="list-style-type: none"> <li>1. There is no evidence that merging firms are able to increase operating performance following acquisitions;</li> <li>2. Cash method is better than stock method.</li> </ol>
US	Linn and Switzer, (2001)	1967-1987	413	Pre-tax cash flow	C	Deal atmosphere: tender or negotiated merger; target size;	<ol style="list-style-type: none"> <li>1. Improvements in post-merger operating performance is greater when deals were paid in cash rather than in stocks;</li> </ol>

						industry relatedness; leverage	<p>2. The dummy variables are not significant in post-merger performance, but cash deal is more positive;</p> <p>3. Relative large targets outperform their small targets</p>
US	Heron and Lie, (2002)	1985-1997	859	Operating income	C + I	Method of payment; experience; industry relatedness	<p>1. There is no evidence on the improvements in post-merger operating performance such factors as: industry relatedness and experience;</p> <p>2. There is no evidence that the method of payment conveys information about the acquirer's future operating performance</p>
US	Moeller & Schlingemann, (2004)	1985-1995	2362	Pre-tax cash flow	I	Global diversification; the freedom of a country's economic and institutional environment	<p>1. US acquirers experience significantly lower operating performance for cross-border than for domestic transactions;</p> <p>2. Bidder returns are negatively related to the target country's degree of economic restrictiveness</p>
UK	Dickerson et al. (1997)	1848-1977	1443	Pre-tax cash flow	Other	Target size; leverage	Acquisitions have a decreasing impact on company performance, and company growth through acquisitions yields a lower rate of return than growth through internal investment



UK	Powell and Stark, (2005)	1985-1993	191	Pre-tax cash flow adjusted for changes in working capital	C + I	Industrial relatedness; the removal of the target CEO; method of payment	<ol style="list-style-type: none"> <li>1. Takeovers completed in the UK result in modest improvements in operating performance;</li> <li>2. Industry relatedness and the removal of the target CEO have an impact on post-takeover performance;</li> <li>3. Method of payment has no significant impact on performance</li> </ol>
UK	Carline et al., (2007)	1995-1994	81	Pre-tax cash flow	C + I	Corporate governance	The corporate governance characteristic of acquiring firms (board ownership, board size, and block-holder control) have a significant impact on operating performance changes following mergers
Japan	Yeh and Hoshino, (2002)	1970-1974	86	ROA, ROE, Sales growth, Employment growth	Other	N/A	Japanese mergers failed to improve the firm efficiency, and even caused deterioration in the firms' operating performance
Japan	Kruse et al., (2002)	1962-1992	46	Pre-tax cash flow	C + I	Industry relatedness; affiliation; relative size of the bidder and target	<ol style="list-style-type: none"> <li>1. Long-term operating performance following the mergers is positive but insignificant;</li> <li>2. Affiliation and relative size have no impact on post-merger operating performance</li> </ol>

Canada	Dutta and Jog, (2009)	1993-2002	1300	Pre-tax cash flow	I	Mode of acquisition; target type; related or unrelated target; payment type; growth or value acquirer; board independence, level of managerial ownership; and relative size of the deals	There is no significant change in pre- and post- acquisition operating performance of Canadian acquiring firms
Australia	Sharma and Ho, (2002)	1986-1991	36	Pre-tax cash flow adjusted for changes in working capital	C + I	Method of payment; industry segment; size of the acquisition	1. Mergers and acquisitions do not improve post-merger operating performance of the acquiring firms; 2. Both method of payment and relative size have no impact on post-merger operating performance
Australia	Humphery-Jenner and Power, (2011)	1993-2007	1900	Operating income	C	Method of payment; deal	1. Australian acquirers significant improvement in post-acquisition operating performance;

						atmosphere; target size	<p>2. Deal atmosphere and method of payment have positive effect on performance but insignificant;</p> <p>3. Large acquisition: most profitability than small one, as a consequence larger acquirers are less under influence of overpayment</p>
Europe	Martynova et al., (2007)	1997-2001	155	Pre-tax cash flow adjusted for changes in working capital	C + I	Method of payment; deal atmosphere; the acquirer's leverage and cash reserves; industry relatedness; relative size of the target; domestic vs cross-border deals	<p>1. There is no significant change in operating firms involved in different takeover characteristics (such as method of payment, geographical scope, and industry-relatedness);</p> <p>2. The performance deteriorates following hostile bids and friendly takeovers;</p> <p>3. The acquirer's leverage had no impact on the post-merger performance of the combined firms, whereas the acquirer's cash holdings are negatively related to performance</p>
Greece	Pazarskis et al., (2006)	1998-2000	50	Profitability, Liquidity and Solvency ratios	C	Type of merger, method of evaluation and method of payment	The operating performance of a firm involved an M&A decreases

Greece	Papadakis and Thanos, (2010)	1997-2001	155	ROA	C	N/A	There is no significant change in operating performance of firms involved in M&As
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Panel B: Emerging countries

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Malaysia	Rahman and Limmack, (2004)	1988-1992	113	Pre-tax cash flow adjusted for changes in working capital	C + I	N/A	Acquisitions improve operating cash flow performance of combined firms in Malaysian acquisitions
India	Pawaskar, (2001)	1992-1995	36	Pre-tax cash flow	Other	Leverage, tax savings, liquidity	There is no significant effect on operating performance of the firms involved in mergers
India	Kumar and Bansal, (2008)	2003	74	Working capital, operating profit, profit before tax, ROE, EPS, debt to equity ratios	Other	N/A	The acquiring firms generate synergy in the long run in the form of higher cash flow, more business, diversification, cost cuttings etc.
India	Mantravadi and Reddy, (2008)	1991-2003	118	6 different financial and operating ratios	C	Industry type	1. Mergers have a slightly positive impact on operating performance of firms in the banking and finance industry;

Russia	Bertrand and Betschinger, (2012)	1999-2008	609	Pre-tax cash flow	Other	Size of the firm, solvency ratio; industry relatedness; state ownership; domestic vs cross-border deals	<p>2. Mergers have a marginal negative impact on operating performance of firms in pharmaceuticals, textiles and electrical equipment sectors</p> <p>1. International acquisitions tend to reduce the performance of acquirers compared to non-acquiring firms;</p> <p>2. Russian acquirers suffer from the inability to leverage value due to low experience and capability when making international acquisitions</p>
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### 3.3 Theoretical Background

In this chapter, the organisational learning and institution-based view are adopted to analyse the effect of cross-border M&As on the post-acquisition performance of Chinese acquiring firms. Levitt and March (1988) defined organisational learning as organisations ‘encoding inferences from history into routines that guide behaviour’. Recently, researchers have discussed four basic constructs related to organisational learning: knowledge acquisition, information dissemination, information interpretation, and organisational memory (Clercq, et al., 2012; Gao, et al., 2008; Huber, 1991; Hult & Ferrell, 1997; Liu, et al., 2016; Santos-Vijande, López-Sánchez, & Trespalacios, 2012; Slater & Narver, 1995). Organisational learning examines the manner in which organisations acquire, understand and use knowledge. It addresses the value of both exploration of new knowledge (Barkema & Vermeulen, 1998; Cohen & Levinthal, 1990; Lane & Lubatkin, 1998; Szulanski, 1996; Tsai, 2001; Zahra & George, 2002) and exploitation of existing knowledge (Galunic & Rodan, 1998; Kogut & Zander, 1993; 1992; Nahapiet & Ghoshal, 1998; Teece, Pisano, & Shuen, 1997; Zander & Kogut, 1995). Consequently, learning ability can be a major source to achieve a firm’s competitive advantage.

Learning through exploration requires the capability to absorb new knowledge from the environment. An organisation will be better able to recognize, understand and utilise new knowledge in an area where it has a knowledge base and experience, than in the area in which it lacks experience. Cohen and Levinthal (1990) have labelled this learning capability as ‘*absorptive capacity*’, and defined it as a firm’s ability to

recognise the value of new information, assimilate it, and apply it for commercial purposes. Under the concept of absorptive capability, researchers have emphasized that prior related experience enhances the development of the path-dependent capabilities of acquisition of external knowledge (Szulanski, 1996; Zahra & George, 2002). The knowledge that a firm has acquired in the past, its past investments and routines repertoire develop the absorptive capacity of the firm (Barkema & Vermeulen, 1998; Cohen & Levinthal, 1990). On the other hand, learning through exploitation entails finding new applications by combining and recombining existing knowledge. Since knowledge resides in the individual or subgroups of organisations, it requires sharing knowledge through international strategic actions (Kogut & Zander, 1992). Kogut and Aander (1992) refer to '*combinative capabilities*' as the ability to find new applications for existing knowledge, which arise from a firm's ability to develop a social community that fosters organisational learning.

The organisational learning has been recognised as an important factor for a company to stay competitive in the highly-complex international business environment. Previous research suggests 'the transfer of an organization's experience from one event to a subsequent one' plays a crucial role in determining success and failure of a strategic action (Barkema & Schijven, 2008). Research in organisational learning implies that the accumulated experience of success and failure gained from the previous strategic action will positively affect the performance of subsequent strategic actions (Amburgey & Miner, 1992; March, 1981). In the context of cross-border acquisitions, the absorptive capacity of an acquiring firm is largely influenced by the acquirer's prior

related experience in making acquisitions (Cohen & Levinthal, 1990), which will be crucial for firms to enhance the performance of post acquisitions (Haleblian & Finkelstein, 1999; Hayward, 2002; Zollo & Singh, 2004). The acquisition experience will lead to the development of routines associated with making acquisitions, such as templates for selecting and evaluating targets and/or guidelines for post-acquisition resource and technical integration, which offers the potential to improve performance of M&As (Lubatkin, 1983). The Chinese serial acquirers can benefit from organisational knowledge, which is derived from experimental learning from previous cross-border M&A activities. Thus, the organisational learning perspective helps underpin the importance of the accumulated experience of a firm involved in cross-border M&As for post-acquisition performance (Collins, et al., 2009; Haleblian, Kim, & Rajagopalan, 2006).

While organisational learning capability can help highlight the importance of internal factors at the firm- and industry-level, it is inadequate to take account of country-level factors, which can also affect the post-integration processes, especially the institutional processes involved in cross-border M&As. Moreover, organisational experience interacts with the environmental context to create knowledge (Argote & Miron-Spektor, 2011). Institutional environment is a key environmental context the organisational experience interacts with, which is important to create knowledge to build competitive advantage and generate desirable performance. Therefore, it is necessary to integrate organisational learning and the institution-based view as the theoretical framework.



The institution-based view is regarded as a pivotal theoretical lens in international business (Buckley, et al., 2007; North, 1990; Peng, 2002; Peng, Wang, & Jiang, 2008; Wan & Hoskisson, 2003; Wright, et al., 2005). Broadly speaking, institutions can be defined as the rules of the game in a society (North, 1990; Williamson, 1998). According to North (1991), they are the humanly devised constraints that structure political, economic and social interaction. In the early study of institutions, Coase (1937) and Williamson (1998; 1994) considered formal and informal institutions as ‘background conditions’ and focused on the determinants of choosing between different governance structures (e.g. markets vs. firms) to reduce transaction costs. By contrast, North (1990) mainly focuses on formal and informal institutions as direct determinants of transaction costs in an economy. Both formal and informal institutions are the focus in this paper. As such we explore under which conditions the firms involved in cross-border M&As can obtain competitive advantage and generate desirable performance.

Formal institutions refer to explicit rules in a society such as regulations, laws, property rights protection or the discipline of economic and political markets and contracts (Dunning & Lundan, 2008; Meyer, et al., 2009). For example, the institutional quality of the host country are used as a proxy for formal institution and influence target firms’ and/or acquiring firms’ behaviour accordingly (North, 1990; Scott, 1995). Informal institutions can be understood as those constraints that people in a society impose upon themselves to give a structure to their relations with others (North, 1990). These rules are transmitted from one generation to another by teaching and imitation (Boyd & Richerson, 1995). Language is a key informal institution (Dunning & Lundan, 2008).

Differences in language significantly increase the difficulties in successfully integrating two previously separate organisations and facilitating communication (Lane, Greenberg, & Berdrow, 2004). In the context of cross-border M&As, the difference between languages makes it hard to have a common scheme within which to understand the difference in corporate culture (Hofstede, 1991). Berger et al. (2001) argue that 'efficiency' barriers such as language difference impede cross-border activity and offset some of the gains of cross-border consolidation, which in turn affect the performance of cross-border M&As.

### **3.4 Hypotheses Development**

From what has been discussed above, we can see that the acquirers' experience contributes to the firms' learning capability regarding knowledge absorption to identify and understand essential knowledge in the organisational learning process, while industry relatedness influence the learning capability regarding knowledge combination to ramp up and integrate newly learned knowledge with existing knowledge to generate competitive advantages. Moreover, the host country's institutional quality reflects the quality of knowledge to be learned in the organisational learning process, while a language difference represents a key barrier for effective communication in the organisational learning process. Four hypotheses are developed which will be introduced in detail in this section.

### **3.4.1 Serial vs. First-time Acquisitions**

The organisational learning theory provides a useful framework for understanding the effect of prior acquisition experience on post-acquisition performance. Existing research in organisational learning implies that the accumulated experience of a firm involved in cross-border M&As will have an impact on future acquisition behaviour and post-acquisition performance (Collins, et al., 2009; Haleblan, Kim, & Rajagopalan, 2006). But, the findings have been mixed about whether such an accumulated experience is sufficient to ensure superior acquisition performance of acquirers from certain countries (Hayward, 2002; Muehlfeld, Sahib, & Witteloostuijn, 2012; Zollo & Reuer, 2003; Zollo & Singh, 2004), because strategic assets often are tacit, specific and complex (Amit & Schoemaker, 1993). Firms need to develop the knowledge and routines to overcome challenges in order to be successful in cross-border M&As (Zollo & Singh, 2004).

In contrast to their peers in Western countries, many Chinese firms conducting cross-border M&As are “first-time buyers” who have not been involved in any cross-border M&As previously. It is important to differentiate between serial acquirers and first-time acquirers in order to investigate the influence of prior acquisition experience on post-acquisition performance.

First, serial acquirers with acquisition experience have better knowledge absorptive capacity about how to identify the value of new and external knowledge in a target firm, how to collaborate with foreign employees and partners, how to operate in a foreign

market, and so on (Haleblian, Kim, & Rajagopalan, 2006; Suh, You, & Kim, 2013; Zhu & Qian, 2015). The crucial prior knowledge obtained from cross-border M&As could generate competitive advantages over their competitors. The prior knowledge will facilitate the development of the acquiring firms' managerial and coordination capabilities and will influence the performance of acquiring firms. The knowledge obtained through cross-border M&As could be even more important to Chinese acquirers who are from a unique institutional environment and political system which are different from the rest of the world. Many Chinese acquirers are state-owned enterprises from a highly protected market at home without any internationalisation experience. Serial cross-border M&As can provide the Chinese acquirers with an opportunity to track the globalisation path of MNEs and examine each step of the foreign expansion and its impact on firm performance. The prior knowledge learned through the past experience of cross-border M&As is crucial for future successful internationalisation (Filatotchev, et al., 2009) and will have a major effect on the business of the acquiring firms. Therefore, serial acquirers can avoid pre- and post-acquisition mistakes and enhance the probability of success in an international market with different institutional settings.

Second, serial acquirers with acquisition experience have better risk management ability in dealing with external environmental risks in foreign countries. Chinese acquirers, many of which are SOE acquirers, lack the knowledge and experience needed for handling environmental risks. In the domestic market, Chinese SOEs are facing minimal environmental risks, including political risks and industry risks, as they are

carefully protected by their major shareholder – the Chinese government. By involving the cross-border M&As, Chinese SOE acquirers will lose such parental care and protection in foreign markets and will be exposed to the high environmental risks which they probably did not encounter before. The knowledge and experience accumulated from past cross-border M&As could be more important for Chinese acquirers in such cases. Based on past acquisition experience, serial acquirers are more experienced at judging the efficacy of their action which enables them to better anticipate external threats pertaining to firms (Beamish, 1988). Furthermore, these firms' ability could also be improved to perform as post-acquisition restructuring and integration tasks (Amburgey & Miner, 1992; Ingram & Baum, 1997) and develop feasible responses to implementation-related challenges. Therefore, more experience in the environmental risk management in foreign countries as well as post-acquisition restructuring and integration will result in the improved performance of Chinese acquirers.

Taking the above arguments together, following the organisational learning literature, the author postulates that, through serial cross-border M&As, Chinese acquirers can learn from both successes and failures from the previous acquisitions which will make future M&As more successful. Chinese serial acquirers have both improved knowledge absorptive ability to identify and assimilate new knowledge from target firms and greater risk management ability in handling environmental risks in foreign markets, which in turn will generate better post-acquisition performance than other 'first-time buyers'. Hence, the author proposes:

**Hypothesis 1:** Firms with serial cross-border M&As perform better than those with first-time cross-border M&As.

### **3.4.2 Horizontal vs Non-horizontal Acquisitions**

Exposure to new external knowledge is just the first step towards generating competitive advantages, but it is not sufficient enough to ensure that a firm can integrate this knowledge successfully with existing knowledge. Firms need to develop learning capabilities regarding knowledge combination to ramp up and integrate acquired knowledge (Zollo & Singh, 2004). However, the industry relatedness may affect the learning process of knowledge integration and combination. It is important to differentiate between horizontal acquisitions and non-horizontal acquisitions in order to investigate the influence of industry relatedness on post-acquisition performance. There are a number of reasons why the industry relatedness matters.

First, Chinese acquirers can more seamlessly integrate new obtained knowledge with their existing knowledge when engaging in horizontal acquisitions. An organisation will be better able to recognize, understand and integrate new knowledge in the industry in which it is familiar with, rather than in an industry in which it has little experience (Darr & Kurtzberg, 2000; Eesley & Robert, 2012). For Chinese acquirers, a broader range of technological knowledge, including R&D, proprietary know-how, patent-protected technology and special tools and machinery, can be obtained with superior marketing knowledge and managerial knowledge to support value creation in Chinese acquiring firms. However, the heterogeneity of knowledge could be a barrier for

knowledge integration and post-acquisition synergy (Zollo & Singh, 2004). The complexity of the post-acquisition synergy process in non-horizontal acquisitions increases substantially in the way in which it articulates and assimilates the heterogeneous knowledge in the different domains and industries. The barrier might be more significant for Chinese acquirers from a closed domestic market with little internationalisation experience. The newly acquired knowledge and skills could more easily be assimilated and combined with their existing homogeneous knowledge through horizontal acquisitions with foreign companies from the same industry rather than non-horizontal acquisition with different business types. The integration and combination of homogeneous knowledge can also enable the Chinese acquirers to obtain cost reduction through the learning curve economy because Chinese acquirers alone may not have sufficient accumulated knowledge and experience to exploit learning curve economies (Ritter & Schooler, 2002).

Secondly, horizontal acquisitions by Chinese firms facilitate acquisition of transferable knowledge and resources from overseas to cultivate their domestic market and thereby improve their post-acquisition performance. There is a huge difference in the objectives of cross-border M&As between Chinese MNEs and those from developed countries. Firms from developed countries are motivated to exploit their own knowledge in the host countries' market, so that vertical acquisition could help market and distribute their products in the host countries. However, many firms from China are engaged to invest in the exploration of relevant knowledge to cultivate their domestic market, so called knowledge-seeking M&As (Child & Rodrigues, 2005; Deng, 2007; Li, Li, & Shapiro,

2012; Wang & Boateng, 2007). Sarala and Vaara (2010) suggested that the acquisition of relevant and transferable knowledge is an important objective for acquisitions and regarded acquisitions as vehicles to access tacit knowledge. The horizontal M&As facilitate the acquisition of transferable knowledge and resources that are not available in the domestic market, and thereby improve the Chinese acquirers' capabilities to be competitive in their home market. An entrepreneurial phenomenon called 'reverse internationalisation' has been recently observed in which Chinese firms employ their knowledge-acquisition capability developed via internationalisation to compete domestically (Chin, Liu, & Yang, 2015; Gnizy & Shoham, 2014). This reverse internationalisation via reverse knowledge transfer (Mudambi, Piscitello, & Rabbiosi, 2014; Rabbiosi, 2011) and reverse market expansion have been seen by many cross-border M&A cases by Chinese firms. For example, following the Chinese acquisition of Volvo Corporation and the acquisition of MG Motor, both Volvo and MG reported record sales in 2015 which were mainly not in the western market of the host companies but in the acquirers' domestic market - China. However, different industrial relatedness might result in a different learning outcome. The degree of homogeneity of knowledge between acquiring and target firms plays an important role in facilitating positive knowledge spillovers from the target firms to Chinese acquirers. The competitive advantage will not be generated if critical knowledge and resources (e.g. trademarks, patents and proprietary technology) acquired from a dissimilar industry are difficult to transfer and integrate with their own knowledge and resources, which will make it less useful in the process of reverse internationalisation.



Therefore, it is expected that horizontal acquisitions could be a better strategic choice for Chinese acquirers in order to realise the objective of cross-border M&As when compared to non-horizontal acquisitions of heterogeneous knowledge in different industries. The combined homogeneous knowledge will enable Chinese acquirers to use a target firm's intangible assets through reverse international knowledge and gain competitive advantages in the domestic market which in turn improves the post-acquisition performance of Chinese acquirers. The discussion above leads to the following hypotheses:

**Hypothesis 2:** Horizontal cross-border M&As have a more positive impact on firm performance than non-horizontal cross-border M&As.

### **3.4.3 The Moderating Effect of Host Country Institutional Quality**

The existing research on post-acquisition synergy focuses on how to transfer knowledge from the acquiring firms to their acquired companies or subsidiaries overseas (Chang, Gong, & Peng, 2012; Fang, et al., 2010; Gonzalez & Chakraborty, 2014). The success of post M&A integration thus depends on MNEs' ability to transfer their valuable knowledge to their acquired companies or subsidiaries overseas. However, many cross-border M&As by Chinese MNEs are driven by a different, namely 'reverse internationalisation' strategy when compared to the internationalisation strategy of their western peers. The previous study (Wang & Boateng, 2007) showed that cross-border M&As by Chinese companies are motivated to invest in exploration of superior knowledge learned via internationalisation to cultivate their domestic market, which

includes superior marketing skills, product differentiation, patent-protected technology and superior managerial knowledge. Therefore, the importance of knowledge transfer from headquarters to acquired companies may not be as significant as expected, especially when the acquired companies are from countries with high institutional quality. Contrarily, reverse knowledge spillovers (Mudambi, Piscitello, & Rabbiosi, 2014), reverse staff movement and reverse market expansion from an acquiree's market to an acquirer's market has been observed through the reverse internationalisation of Chinese firms (Chin, Liu, & Yang, 2015). Considering this special need of Chinese acquirers, when we are investigating the organisational learning in M&As by Chinese firms, we should not only consider the *quantity of knowledge* which can be obtained through the organisational learning process, but also the *quality of knowledge*, especially *quality of tacit knowledge*, available to be transferred from the host countries to China.

First, Chinese firms are more likely to obtain high-quality knowledge from host countries with high institutional quality, given that countries with high institutional quality are developed countries (WGI, 2015). Cross-border M&As happen when the deficit in resource and capability cannot be bridged through internal development or acquisitions from the domestic market (Deng, 2009; Luo & Tung, 2007; Rui & Yip, 2008). M&As are an important solution used by Chinese firms to exchange resources and capabilities that are otherwise not possible to obtain in the domestic market (Capron, Dussuage, & Mitchell, 1998; Lubatkin, et al., 2001; Nicholson & Salaber, 2013). For acquirers from China which is a country with relatively low institutional quality

(according to WGI, 2015), the required advanced and high-quality knowledge is more likely to be obtained from countries with high institutional quality, instead of the other similar countries with low institutional quality. Host countries with underdeveloped institutions offer limited opportunities for knowledge exploration (Petersen, Pedersen, & Lyles, 2008). Acquiring an existing company located in the country with high institutional quality is a quick way to gain access to new knowledge available in the country, including innovation, new technology and processes. These strategic assets are crucial for Chinese acquirers who lack advanced technology and international brands. Thus, serial Chinese acquirers will achieve a better post-acquisition performance when acquiring a target firm from a country with high institutional quality.

Secondly, post-acquisition integration and synergy in the host countries with high institutional quality is an important organisational learning process for Chinese firms in assimilating the superior knowledge and ramping up the knowledge for their own needs. The acquirers participating in serial cross-border M&As in the host countries with high institutional quality will not only develop the ability to identify the value of new external knowledge in a target firm, collaborate with foreign employees and partners on how to operate in a foreign market, but also have more opportunities to assimilate and merge new knowledge acquired from the countries with high institutional quality during post-acquisition integration and synergy. The accumulative competitive advantages could be achieved through the serial cross-border M&As taking place in the host countries with high institutional quality instead of those in the countries with low institutional quality. The learning curve effect will occur which

improves the post-acquisition performance of Chinese acquirers. Hence, the author proposes:

**Hypothesis 3a:** The positive effect of serial cross-border M&As on the post-acquisition performance of Chinese acquiring firms is stronger for serial cross-border M&As taking place in the host countries with high institutional quality.

Institutional quality will not only moderate the relationships between serial acquisitions and post-acquisition performance, but also the relationship between horizontal acquisition and post-acquisition performance. While knowledge homogeneity resulting from industry similarity will facilitate knowledge transfer and integration in horizontal acquisitions, the knowledge transfer and integration process will also be affected when it is exposed to the potential external risks and uncertainty involved in the knowledge transfer. When host-country institutions are underdeveloped, the institutional environment tends to be risky (Wang, et al., 2013). Chinese firms operating there are subject to increasing external uncertainty and decreasing institutional credibility (Agarwal & Ramaswami, 1992; Akhter & Lusch, 1998; Delios & Beamish, 1999; Delios & Henisz, 2000; Henisz, 2000) which will influence the process of organisational learning and homogeneous knowledge integration and in turn reduce the post-acquisition performance of Chinese acquirers.

High institutional quality will help facilitate the acquisition of transferable knowledge and resources from overseas to cultivate their domestic market. The new knowledge obtained in horizontal acquisitions will be transferred from the target firms to Chinese

acquirers in a speedy fashion when the target firm is from a country with high institutional quality. An EMNE will rely more on internal resources and knowledge instead of inter-organisational resource exchanges when facing uncertainty stemming from the unstable external environment (Feinberg & Gupta, 2009). Chinese acquirers, who lack international managerial expertise, international market knowledge and advanced proprietary technology, would be able to acquire these strategic resources through horizontal acquisitions in host countries with well-developed institutions. These strategic resources include higher-value front-end capabilities and advanced knowledge available in the market with high institutional quality. By seamlessly combining these relevant higher-value front-end resources with existing low-cost back-end capabilities developed at home, Chinese acquirers can generate a unique, joint competitive advantage over their competitors in the domestic market (Deng, 2009; Nicholson & Salaber, 2013) through horizontal acquisitions in the host countries with high institutional quality, which will in turn boost the performance of Chinese acquirers. Hence, we propose:

**Hypothesis 3b:** The positive effect of horizontal cross-border M&As on the post-acquisition performance of Chinese acquiring firms is stronger for horizontal cross-border M&As taking place in the host countries with high institutional quality.

#### **3.4.4 The Moderating Effect of Language**

As discussed above, organisational learning plays an important role in the creation of synergies in cross-border M&As by Chinese firms. Acquisitions are often justified by

accessing and creating new knowledge, because they provide a precious opportunity for organisational learning (Junni, 2005). Communication, visits, and meetings between the Chinese acquiring firms and overseas acquired firms facilitate effective knowledge acquisition for value creation. The study by Schweiger and DeNisi (1991) shows that effective communication can reduce negative short-term and long-term implications of M&As based on psychology and organisational behaviours. Moreover, rich communication is necessary to solve ambiguity. The existing research (Fai & Piekkari, 2003; Henderson, 2005; Ranft, 1997) shows that effective communication is essential for successful knowledge acquisition and is necessary to solve inherent ambiguity occurring during the transfer of tacit knowledge. However, the language barrier restricts effective communication.

Language is an important element of informal institutions. 'Language is the basic social institution in the sense that all others presuppose language, but language does not presuppose the others' (Searle, 1995). Language is associated with knowledge transfer which has long been recognised as a key source of competitive advantages in setting up business in a foreign market (Dunning, 1993). In cross-border M&As, language differences can create misunderstandings, confusion, and frustration in the process of communication that can hinder learning and the development of a social community that supports learning (Buckley, et al., 2005; Schoenberg, 2001; Tietze, 2008). The previous studies (Barner-Rasmussen & Björkman, 2005; Harzing, Köster, & Magner, 2011) have found that language is an important barrier, slowing down the organisational learning and increasing the cost of decision making, and suggested that all MNEs

should find proper ways to deal with the language barriers when expanding into foreign markets which do not share the same language of their home markets.

Having examined the language barrier in organisational learning and effective communication, the author goes on to explore the importance of common language in the specific context of China and the role of the Chinese language in the process of organisational learning between Chinese acquirers and target firms. The Chinese language is one of oldest living languages in the world. Belonging to two different language families, English and Chinese have many significant differences which makes learning Chinese a serious challenge for English native speakers, and vice versa. The Chinese language has been regarded as one of the most difficult languages for native English speakers. In the US, less than 1% of people can speak Chinese according to the American Community Survey 2009. Similarly in China, English speakers in China is only about 0.73%, one of the lowest in the world (Yang, 2006). However, common language is one of the key factors associated with the transfer of tacit knowledge (Joia & Lemos, 2010). If the cross-border M&As take place in one of the Chinese speaking regions (e.g. Hong Kong, Taiwan, Singapore or Marco), the common language will facilitate the organisational learning between Chinese acquirers and overseas target firms through serial M&As and significantly reduce the operating cost and delay of foreign language training and document translation.

Serial acquirers can accumulate more knowledge and experience from each of the previous cross-border M&As when cross-border M&As take place in Chinese speaking regions/countries. Common language plays an important role in facilitating positive

organisational learning from past experiences. Effective communication in organisational learning will enable serial acquirers to better learn the pre- and post-acquisition mistakes which will make their next cross-border M&As more successful, especially enhancing the probability of success in a market with the same informal institutional settings. Moreover, by removing the communication barrier, the post-acquisition integration and synergies will not only happen between Chinese acquirer and target firms, but also among different target firms from serial M&As occurring in Chinese speaking regions/countries. Higher levels of integration among the Chinese acquirer and target firms are necessary in order to explore the value creation potential of serial cross-border M&As through cost saving or through revenue enhancing mechanisms (Anand & Singh, 1997; Capron, Dussuage, & Mitchell, 1998; Singh & Montgomery, 1987), and thereby improves the post-acquisition performance. Hence, the author hypothesises:

**Hypothesis 4a:** The positive effect of serial cross-border M&As on the post-acquisition performance of Chinese acquiring firms is stronger for serial cross-border M&As taking place in Chinese speaking regions/countries.

Language has been identified as a key part of the firm's comparative advantage in doing business in foreign markets (Dinning, 1993). Language difference increases uncertainty, which can result in lower trust and interaction avoidance, which in turn results in lower commitment to each other in the long run (Gudykunst, 1995). This would make the sharing of knowledge and information difficult between both sides (Buckley, et al., 2005), even though the acquiring firm and the target firm are in the same industry. As



discussed in section 3.4.2, knowledge homogeneity will facilitate knowledge transfer and organisational learning in horizontal acquisitions. However, the successful knowledge transfer not only relies on the property of knowledge itself, but also the communication channel by which knowledge is transferred.

First, knowledge transfer requires the use of language to enable articulation in order to promote the assimilation of acquired knowledge. Articulation is a process of interpreting transferred knowledge to make it understandable, which is an important step in the organisational learning process to understand, test and share the transferred knowledge (Hedlund & Nonaka, 1993). According to the study by Buckley (2005), the success of knowledge transfer depends on the level of language skills of employees in both parties and language differences between foreign employees and local staff have been a primary barrier in the assimilation of transferred knowledge. The integration and combination process of new knowledge occurred in horizontal acquisitions could be interrupted if the knowledge is encoded in different languages. However, if the horizontal M&As were taking place in the Chinese language speaking regions/countries, this primary barrier for knowledge transfer would be removed in horizontal acquisitions, which in turn promotes organisational learning between Chinese acquirers and target firms.

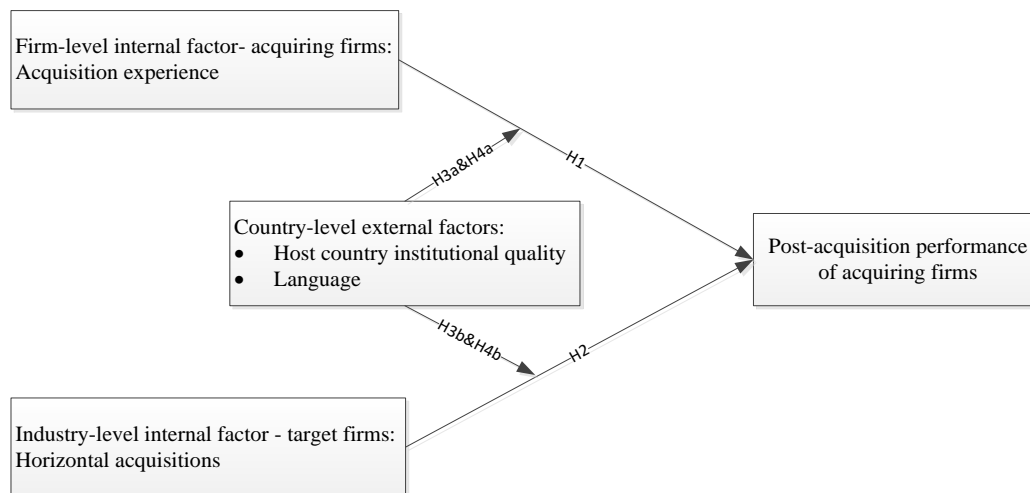
Secondly, a common language can minimize the potential for miscommunication and provide easy access to company documents (e.g. technical, product manuals and financial reports). Due to limited foreign language skills of Chinese acquirers and limited Chinese language ability of foreign targets (in a non-Chinese language speaking

regions/countries), a significant amount of technical and managerial documents need to be translated which imposes significant cost and delay in the organisational learning process. Moreover, common language will improve individual communication and information exchanges through employees between acquiring and acquired firms in horizontal M&As who share the same interests and technical expertise. Bi-directional staff exchanges would be promoted by easily sharing their knowledge and experience with their overseas peers of the same occupation. As differences in language represent the biggest obstacle for knowledge exchange (Buckley, et al., 2005; Harzing, Köster, & Magner, 2011; Liu, et al., 2015; Piekkari, et al., 2005), a common language will facilitate knowledge exchange across all the levels of acquiring firms and target firms in the same industry. The knowledge exchange will not only occur at the senior management level, but also among all middle level and first line managers and employees with similar knowledge structure and expertise.

In summary, from the individual perspective, a common language would remove the language barrier in communication between managers in acquiring firms and those in target firms for the sharing of individual managerial experience of the same industry in horizontal M&As. From the firm perspective, a common language would facilitate the post-acquisition knowledge transfer, resource re-deployment and sociocultural and managerial integration in horizontal M&As. This will improve post-acquisition synergies and enhance capability which in turn improves the post-acquisition performance. Hence, the author proposes:

**Hypothesis 4b:** The positive effect of horizontal cross-border M&As on the post-acquisition performance of Chinese acquiring firms is stronger for horizontal cross-border M&As taking place in Chinese language speaking regions/countries.

Figure 4.1 summarises the conceptual framework adopted in this chapter. It shows that acquisition experience (e.g. serial acquisitions and first-time acquisitions) and industry relatedness (e.g. horizontal acquisitions and non-horizontal acquisitions) might affect the long-term operating performance of acquiring firms. However, because of the mechanisms discussed in the above, we expect that serial acquisitions and horizontal acquisitions have a positive and significant impact on the performance of acquiring firms (H1 and H2). In addition, different institutional environments have different moderating effects. As a proxy of formal institution, we propose that the positive moderating effect of a host country's institutional quality is more pronounced when Chinese acquiring firms have prior acquisition experience (H3a) and invested in the same industry (H3b). As a proxy of informal institution, we also expect the moderating effect of language to be stronger when Chinese acquiring firms have prior acquisition experience (H4a) and invested in the same industry (H4b).



**Figure 3.1 The Conceptual framework**

## 3.5 Data and Methodology

### 3.5.1 Data

Two different data sources are used to create the dataset for this study. The first is Thomson One Banker produced by Thomson Financial Corporation, which provides data on aggregate cross-border M&A activities. These data include information on the data of M&A announcement, the name of the primary stock exchange, primary ticker symbol, etc. The second data source is China Stock Market & Accounting Research Database (CSMAR) developed by Shenzhen GTA Information Technology Company. CSMAR is the comprehensive database for Chinese business research, which covers data on the Chinese stock markets, financial statements and China Corporation Governance of Chinese listed firms.

The data on cross-border M&As by Chinese firms from January 2000 to December 2012 was obtained from the Thomson One Banker database. The data should meet the following criteria: (i) the M&A deals are listed as completed transactions; (ii) the sample is limited to firms with stock price data which is available on the Shanghai, and Shenzhen stock exchanges. Firm-level financial data is collected for acquiring firms for the 2000-2012 period from CSMAR. A Chinese firm should meet both of the following criteria in order to be included in the sample: (i) the firm should be a public firm listed in the Shanghai and Shenzhen stock exchange; and (ii) the firm has released comprehensive information on the explanation variables in their financial statements. The financial statements in the period of 2000-2012 of all Chinese listed firms have been retrieved from CSMAR. The final sample includes 121 cross-border M&A deals by 82 Chinese firms, which leads to 736 observations over the period of 2000-2012.

### **3.5.2 Variable Measurement**

#### *Dependent variable*

To capture the financial aspect of firm performance, an accounting profitability measure, return on asset (ROA), is used to measure performance, which is the most commonly used profitability measure in economics or management studies (Capar & Kotable, 2003; Lu & Beamish, 2004). ROA is measured as the Earnings Before Interest and Taxes (EBIT) divided by the amount of total assets of a firm.

#### *Independent variables*

### *Serial vs. First-time acquisitions*

To capture foreign investment experience of cross-border M&As, two dummy variables are employed, namely serial cross-border M&As and first-time cross-border M&As. The author classified a Chinese acquirer as a serial acquirer if the acquiring firm has prior acquisition experience. The author codes 1 for companies with serial cross-border M&As and 0 for otherwise. A Chinese acquirer is regarded as a first-time acquirer if the acquiring firm does not have any prior acquisition experience. The author codes 1 for companies with only one cross-border M&A and 0 for otherwise.

### *Horizontal vs. Non-horizontal acquisitions*

Furthermore, to distinguish the industry relatedness between the acquiring firms and target firms, two other dummy variables are employed, namely horizontal cross-border M&As and non-horizontal cross-border M&As. The author classified the cross-border M&A deals as horizontal ones if the acquirer and the targeting firms occur in the same industry. The author codes 1 for horizontal M&As and 0 for otherwise. If the acquirer and the targeting firms do not occur in the same industry, the cross-border M&As are defined as non-horizontal M&As. The author codes 1 for non-horizontal M&As and 0 for otherwise.

### *Moderating variables*

#### *Host country institutional quality*

Based on previous studies (Cuervo-Cazurra & Genc, 2008; Slangen & Tulder, 2009), the author uses the *worldwide governance indicators (WGI)* developed by Kaufmann et al. (2010) to capture the host country's institutional quality. These indicators emphasise, by construction, different aspects of governance: voice and accountability; political stability; absence of violence; government effectiveness; regulatory quality; rule of law; and control of corruption. The WGI indicators cover 215 countries and territories for the period 1996 to 2013 and follow a normal distribution with a mean of zero and a standard deviation of one in each period, which indicates final scores lying between -2.5 and 2.5, with higher values representing advanced institutional environments in the country of origin of respective target firms (Dikova, 2009), which the author names as a target country. Therefore, for each target country in our sample, the author takes the mean across these indicators to obtain the final value. Values  $\geq 0$  reflect higher levels of institutional quality, whereas those  $< 0$  indicate lower levels of institutional quality. The author takes the value of 1 for higher levels of institutional quality, 0 for otherwise.

### *Language*

The target countries will be classified into two broad categories - M&As taking place in Chinese language speaking regions/countries and M&As taking place in other regions/countries to see how the culture and language differences will moderate the relationship between post-acquisition performance and independent variables. Therefore, if M&As took place in a Chinese language speaking region/country, the

corresponding transaction in the sample would receive a coding of 1. Otherwise the variable would receive a coding of 0.

### *Control variables*

When examining the relationship between cross-border M&As and firm performance, it is necessary to control for other factors that may also influence performance. Given that state-owned enterprises enjoy preferential status in obtaining loans and other key inputs (Brandt & Li, 2003), the author controls for state ownership. State shareholding is calculated as the percentage of states owned by central government, local governments and government related agencies. The author also includes foreign shareholdings to control for the influence of foreign investors, which is measured as the percentage of equity shares owned by foreign investors. The author controls for firm size as a proxy of a firm's resources and capabilities, which is measured by the natural logarithm of firm total assets. Larger firms can benefit from larger economies of scale and scope and also have more slack resources for internationalisation. The author also controls for firm age as a proxy of experience and resource, which is measured by the number of years since establishment. Debt-equity ratio is controlled for slack resources.

### **3.5.3 Method**

In this study, a panel design is selected to show time-varying influences on performance. Panel data, also called longitudinal data or cross-section time-series data, is a dataset that follows a given sample of individuals over time, and thus provides multiple observations on each individual in the sample. Compared with traditional cross-



sectional or time-series data, panel data can give researchers a large number of data points which allows it to increase the degree of freedom and reduce the collinearity among explanatory variables and hence improve the efficiency of econometric estimates (Hsiao, 2003).

It should be considered that profitability measures (dependent variable) could be at least partially persistent over time (Mueller, 1990) and thus a lagged dependent variable should be included in the empirical analysis. Therefore, this study used the dynamic panel model to test the hypothesized impacts of the independent and moderating variables on post-acquisition performance of Chinese acquiring firms. The empirical model the author analyses is:

$$y_{it} = \beta_0 + \beta_1 y_{i,t-1} + \beta_2 x_{it} + \beta_3 (x_{it} * I_{it}) + \beta_4 C_{it} + \eta_i + \varepsilon_{it} \quad (1)$$

Where  $y_{it}$  is a proxy of the post-acquisition performance of firm  $i$  at time  $t$ .  $y_{i,t-1}$  is the lagged independent variable to account for dynamic effects in performance;  $x_{it}$  refers to a vector of independent variables proposed in the hypotheses;  $I_{it}$  stands for a vector of moderating variables;  $x_{it} * I_{it}$  indicates a vector of moderating terms; and  $C_{it}$  represents a vector of control variables.  $\eta_i$  is the firm specific effect.  $\varepsilon_{it}$  is the idiosyncratic error term with  $E(\varepsilon_{it})=0$ .

In order to estimate Eqs. (1), the author employs a Generalised Method of Moment estimation (GMM) for the dynamic panel data model, which is a commonly used estimation procedure to estimate the parameters in a dynamic panel data model with

unobserved individual specific heterogeneity (Bertrand & Zuniga, 2006; Gugler & Yurtoglu, 2004; Hakkala, Heyman, & Sjöholm, 2010; Hansen, 1982; Harris & Robinson, 2002). In the case of OLS this would give rise to a dynamic panel bias, which does not account for the time-series dimension of data and the unobserved firm-specific heterogeneity. To account for unobserved heterogeneity in GMM estimations, Anderson and Hsiao (1982) introduced a GMM estimator for first-differenced data, proposing twice-lagged differences or levels, while Arellano and Bond (1991) defined additional orthogonality conditions to increase the efficiency of the estimators. Arellano and Bond (1991)'s first-differenced GMM estimator eliminates the firm-specific effect and uses all possible lagged levels as instruments.

However, Blundell and Bond (1998) point out that the first-differenced GMM estimators are likely to have sample bias when the time series are persistent and the number of time period is small. This is because lagged levels of the series provide only weak instruments for the differenced equations. Another disadvantage of using the difference estimator is that the process of differencing to remove the firm specific effect also eliminates information on the cross-firm variation in levels. The system GMM estimator proposed by Arellano and Bover (1995) and Blundell and Bond (1998) was developed by adding the dependent variables in levels to the transformed dataset, differencing the instruments to make them exogenous to fixed effects. The standard errors are reported with the Windmeijer correction (Windmeijer, 2005) without which standard errors would be downward biased. Finally, the two standard tests are applied to evaluate the relevance of the GMM model. The first is the Arellano and Bond test,

which examine the hypothesis to which the error term is not serially correlated. Under the null hypothesis of no serial correlation, this test is distributed standard-normal. The second is the Hansen test of over-identifying restrictions, which tests the overall validity of the instruments. Failure to reject the null hypothesis of both tests gives support to the model specification.

### **3.6 Empirical Results**

The means, standard deviations, and correlations for all variables used in this study are reported in Table 3.2, while the results of the empirical analysis are reported in Table 3.3 and 3.4. In all these tables, the results of the Hansen test of over-identifying restrictions provide no grounds to reject the validity of the instrument. And AR(2) tests show no evidence of second order serial correlation.

**Table 3.2 Summary statistic and correlations**

	Mean	SD	1	2	3	4	5	6	7	8	9	10	11	12
1 ROA	0.049	0.105	1.000											
2 Serial CBMAs	0.110	0.313	0.042	1.000										
3 First-time CBMAs	0.295	0.456	0.090	-0.222	1.000									
4 Horizontal CBMAs	0.126	0.332	0.068	0.238	0.340	1.000								
5 Non-horizontal CBMAs	0.308	0.462	0.085	0.455	0.560	-0.054	1.000							
6 Language	0.137	0.344	-0.030	0.287	0.314	0.408	0.370	1.000						
7 Institutional quality	0.346	0.476	-0.132	0.289	0.750	0.485	0.674	0.492	1.000					
8 State shareholdings	0.218	0.263	0.043	-0.082	-0.240	-0.123	-0.208	-0.168	-0.253	1.000				
9 Foreign shareholdings	0.021	0.073	0.050	-0.087	-0.009	-0.026	-0.064	0.036	-0.038	-0.053	1.000			
10 Firm age	10.024	4.727	0.070	0.204	0.274	0.171	0.325	0.214	0.368	-0.270	-0.224	1.000		
11 Firm size	9.651	0.834	-0.013	0.350	0.092	0.113	0.303	0.251	0.217	-0.012	-0.061	0.279	1.000	
12 Debt-equity ratio	1.332	3.680	0.096	0.086	-0.082	-0.011	-0.019	0.402	-0.006	0.008	-0.047	0.142	0.310	1.000

Table 3.3 presents the system GMM estimator results for the post-acquisition performance in each of different type of cross-border M&As. Model 1 presents the results for all control variables. Model 2, model 3 and model 4 show the results of the main effects depicted in Hypotheses 1 and 2, respectively. Hypothesis 1 states that firms with serial cross-border M&As perform better than firms with first-time cross-border M&As. As shown in model 2 and model 4 in Table 3.3, serial cross-border M&As were positively associated with the post-acquisition performance ( $\beta=0.034$  and  $0.029$ ,  $p<0.01$ ). However, there is no significant relationship for first-time cross-border M&As in post-acquisition performance ( $\beta=0.002$  and  $0.011$ ,  $p>0.10$ ). These results provide support for Hypothesis 1.

Hypothesis 2 posits that firms with horizontal cross-border M&As have a more positive impact on firm performance. Model 3 and model 4 in Table 3.3 indicate that the relationship between horizontal cross-border M&As and post-acquisition performance are positive but not significant ( $\beta=0.002$  and  $0.004$ ,  $p>0.10$ ). In contrast, non-horizontal cross-border M&As have a negative influence on post-acquisition performance ( $\beta=-0.006$ ,  $p>0.10$ ). From the results, it can be seen that firms with horizontal cross-border M&As still perform better than those with non-horizontal cross-border M&As. But the relationship between horizontal acquisitions and operating performance is not significant. Therefore, Hypothesis 2 is not supported.

**Table 3.3 Results of system GMM estimation**

	Model 1	Model 2	Model 3	Model 4
ROA <sub>t-1</sub>	0.133*** (0.020)	0.109*** (0.015)	0.107*** (0.015)	0.088*** (0.010)
State shareholdings	0.010 (0.030)	0.078 (0.008)	0.039 (0.024)	0.039 (0.014)
Foreign shareholdings	0.075 (0.083)	0.823 (0.289)	0.073 (0.073)	0.052 (0.042)
Firm age	0.001 (0.001)	0.005*** (0.001)	0.001 (0.001)	0.000 (0.000)
Firm size	-0.048*** (0.010)	-0.035*** (0.007)	-0.019 (0.014)	-0.033*** (0.007)
Debt-equity ratio	0.018*** (0.004)	0.007*** (0.001)	0.012*** (0.003)	0.004*** (0.001)
H1: Serial cross-border M&As		0.034*** (0.008)		0.029*** (0.011)
First-time cross-border M&As		0.002 (0.009)		0.011 (0.008)
H2: Horizontal cross-border M&As			0.002 (0.009)	0.004 (0.004)
Non-horizontal cross-border M&As			-0.006 (0.011)	0.000 (0.007)
Constant	0.476*** (0.084)	0.288*** (0.066)	0.205* (0.123)	0.341*** (0.069)
Observations	736	736	736	736
Number of firms	82	82	82	82
Hansen test <sup>a</sup>	0.329	0.841	0.420	0.810
AR(2) <sup>b</sup>	0.266	0.238	0.247	0.189

Notes: The dependent variable is ROA. The results reported in this table have been obtained using dynamic system GMM estimators using the two-step estimation including the Windmeijer correction to the reported standard errors. Data is for 2000-2012. Standard errors are in parentheses.

\* p<0.1, \*\* p<0.05, \*\*\* p<0.01

a The null hypothesis is that the instruments used are not correlated with the residuals.

b The null hypothesis is that the errors in the first-difference regression exhibit no second-order serial correlation.

Table 3.4 shows the interactions between the serial and horizontal cross-border M&As and the two different institutional environments. The direct impact of country-level factors (i.e., host country's institutional quality and language) on the dependent variable has been tested in Model 1. The coefficient of host country's institutional quality and language is negative and insignificant ( $\beta=-0.039$  and  $-0.005$ ,  $p>0.10$ ), indicating that host country's institutional quality and language do not have direct impact on the post-acquisition operating performance of the acquiring firms.

Model 2 and model 4 in Table 3.4 show that the interaction between serial acquisition and institutional quality ( $\beta=0.043$  and  $0.051$ ,  $p<0.05$ ) and the interaction between horizontal acquisitions and institutional quality ( $\beta=0.046$  and  $0.038$ ,  $p<0.10$ ) are all positive and significant. These results indicate that host country's institutional quality positively moderated the relationship between serial cross-border M&As and post-acquisition performance and the relationship between horizontal cross-border M&As and their operating performance. Hypothesis 3a and 3b are therefore supported.

Also, as for the moderating effect of language, the results provide support for hypothesis 4a and 4b. Model 3 and model 4 in Table 3.4 show that there are statistically significant positive relationship between serial acquisitions and language ( $\beta=0.104$  and  $0.113$ ,  $p<0.01$ ) and between horizontal acquisitions and language ( $\beta=0.088$  and  $0.064$ ,  $p<0.05$  and  $p<0.01$ ). These results indicates that language positively moderates the relationship between serial cross-border M&As and post-acquisition performance and between horizontal cross-border M&As and post-acquisition performance. Therefore, hypothesis 4a and 4b are confirmed.

**Table 3.4 Results of system GMM estimation: Moderating effects**

	Model 1	Model 2	Model 3	Model 4
ROA <sub>t-1</sub>	0.110 <sup>***</sup> (0.015)	0.126 <sup>***</sup> (0.011)	0.131 <sup>***</sup> (0.013)	0.127 <sup>***</sup> (0.009)
State shareholdings	0.010 (0.022)	-0.014 (0.014)	0.003 (0.009)	-0.005 (0.012)
Foreign shareholdings	0.143 (0.025)	0.235 (0.015)	0.284 (0.037)	0.169 (0.040)
Firm age	0.005 <sup>***</sup> (0.001)	0.006 <sup>***</sup> (0.001)	0.008 <sup>***</sup> (0.001)	0.008 <sup>***</sup> (0.001)
Firm size	-0.044 <sup>***</sup> (0.006)	-0.022 <sup>***</sup> (0.004)	-0.039 <sup>***</sup> (0.007)	-0.038 <sup>***</sup> (0.004)
Debt-equity ratio	0.015 <sup>***</sup> (0.001)	0.013 <sup>***</sup> (0.001)	0.013 <sup>***</sup> (0.001)	0.013 <sup>***</sup> (0.001)
Serial CBMAs	0.023 <sup>**</sup> (0.011)	0.019 <sup>*</sup> (0.014)	0.014 (0.015)	0.039 <sup>***</sup> (0.015)
Horizontal CBMAs	0.002 (0.015)	0.039 <sup>***</sup> (0.009)	0.021 (0.026)	0.037 <sup>*</sup> (0.009)
Institutional quality	-0.039 (0.026)	-0.034 <sup>*</sup> (0.019)	-0.019 (0.031)	-0.035 <sup>*</sup> (0.019)
Language	-0.005 (0.036)	-0.136 <sup>***</sup> (0.043)	-0.181 <sup>***</sup> (0.037)	-0.154 <sup>***</sup> (0.030)
H3a: Institutional quality*Serial CBMAs		0.043 <sup>**</sup> (0.021)		0.051 <sup>**</sup> (0.023)
H3b: Institutional quality*Horizontal CBMAs		0.046 <sup>*</sup> (0.025)		0.038 <sup>*</sup> (0.022)
H4a: Language*Serial CBMAs			0.104 <sup>***</sup> (0.025)	0.113 <sup>***</sup> (0.024)
H4b: Language*Horizontal CBMAs			0.088 <sup>**</sup> (0.039)	0.064 <sup>*</sup> (0.039)
Constant	0.417 <sup>***</sup> (0.055)	0.197 <sup>***</sup> (0.036)	0.324 <sup>***</sup> (0.068)	0.335 <sup>***</sup> (0.037)
Observations	736	736	736	736
Number of firms	82	82	82	82
Hansen test <sup>a</sup>	0.569	0.766	0.682	0.909
AR(2) <sup>b</sup>	0.331	0.299	0.325	0.316

Notes: The dependent variable is ROA. The results reported in this table have been obtained using dynamic system GMM estimators using the two-step estimation including the Windmeijer correction to the reported standard errors. Data is for 2000-2012. Standard errors are in parentheses.



\* $p < 0.1$ , \*\* $p < 0.05$ , \*\*\* $p < 0.01$

a The null hypothesis is that the instruments used are not correlated with the residuals.

b The null hypothesis is that the errors in the first-difference regression exhibit no second-order serial correlation.

### **3.7 Discussion**

With the increasing importance of EMNEs in international investment (Buckley, et al., 2007; Deng, 2012 ; Wang, et al., 2012), this study examines whether cross-border M&As, initiated by emerging economies in different destinations, affect their operating performance. The results suggest that, at the firm-levels, cross-border M&As tend to increase the operating performance of Chinese acquiring firms when making serial acquisitions. The positive impact of serial acquisitions can be explained through the lens of the organisational learning theory. The prior knowledge learned through the past experience of cross-border M&As plays a crucial role in identifying the value of external knowledge in target firms and enhancing post-acquisition integration and synergy. Moreover, Chinese acquirers, especially for Chinese SOE acquirers, will lose the parental protection of their main shareholder, the Chinese government, and may have to face high environmental risks which they probably have never experienced before. The knowledge and experience obtained from previous cross-border M&As will be very important in dealing with external risks and threats which in turn results in the improved performance of Chinese acquirers. Therefore, firms with serial cross-border M&As perform better than those with first-time cross-border M&As.

The author also explores the moderating effects of host country institutional quality. The findings indicate that the positive effects of serial cross-border M&As and horizontal cross-border M&As on the post-acquisition performance of Chinese acquiring firms are stronger for cross-border M&As taking place in host countries with high institutional quality. Acquiring a target company located in the countries with high

institutional quality represents a fast way to gain access to superior knowledge and resources which usually are not available in the closed domestic market. Therefore, the host-country institutional quality positively moderates the effect on the post-acquisition performance of Chinese acquiring firms. The positive effect of institutional quality is consistent with our study on overseas subsidiary performance in host countries (Liu, et al., 2016), while this study further illustrate the importance of high institutional quality in generating good performance in both host and home countries for acquiring firms.

Furthermore, the author also examines the moderating effects of language. The author has found that the positive effects of serial cross-border M&As and horizontal cross-border M&As on post-acquisition performance of Chinese acquiring firms are stronger for cross-border M&As taking place in Chinese speaking regions/countries. Compared to the other language, Chinese language has been regarded as one of the most difficult languages for native English speakers. In the US, less than 1% of people can speak Chinese, while less than 1% of people in China can speak English, one of the lowest countries in the world (Yang, 2006). Language difference is a significant barrier for effective communication between Chinese acquirers and target firms from non-Chinese speaking regions/countries during post-acquisition integration and synergy. While target firms are from Chinese speaking regions/countries, the common language will facilitate organisational learning between Chinese acquirers and overseas target firms. The learning process will not be restricted to the senior level management teams but also to the individual employees who are the connectors between the acquiring and

acquired firms in horizontal M&As and have similar technical expertise. This will positively enhance the post-acquisition performance of Chinese firms.

### **3.8 Summary**

In recognition of the rapid pace and increasing importance of cross-border M&As by Chinese firms, the author focused on the timely and important research issue of post-acquisition operating performance of cross-border M&As by Chinese firms, which is different from the majority of research conducted on this area addressing the short-term market performance of M&As by Chinese firms (Du & Boateng, 2015; Gubbi, et al., 2010; Ning, et al., 2014). Inspired by different motivations for the exploration of superior knowledge by Chinese acquirers, the author tackles this challenging issue by combining organisational learning and institution-based view by systematically investigating the influence of internal factors and external factors on the post-acquisition performance of Chinese EMNEs at the firm, industry and country levels.

In this chapter, the author applies dynamic panel data model to investigate the impact of cross-border M&As on the post-acquisition operating performance of Chinese acquiring firms. The findings indicate that firms with serial cross-border M&As achieved better performance than those with first-time cross-border M&As. The positive effects of acquisition experience and horizontal acquisitions on post-acquisition performance of Chinese acquiring firms are reinforced for cross-border M&As taking place in host countries with high institutional quality. This study sheds new light on the contingency of the institutional environment of a host-country and

EMNE performance. The moderating effect of the Chinese language has also been examined in this study where Chinese language speaking regions strengthened the positive implications of serial cross-border M&As and horizontal acquisitions on the post-acquisition performance of Chinese acquiring firms. Thus, the study advances research on the post-acquisition performance of EMNEs by providing new insights into the role of the acquirers' acquisition experience and industry relatedness on knowledge exploration and knowledge integration in host countries with different institutional qualities and different spoken languages.

## **4. Expatriates, Subsidiary Autonomy and Overseas Subsidiary Performance**

### **4.1 Introduction**

In this chapter, the author tackles the performance issues from a management perspective by investigating how Chinese MNEs dynamically respond to performance challenges using different management strategies to improve the performance of overseas subsidiaries. This part of the research addresses the third research question of the thesis – ‘How Chinese MNEs respond to the institutional factors by using different levels of expatriates and subsidiary autonomy to improve the performance of overseas subsidiaries given host countries’ institutional conditions?’

Over recent decades, the impact of expatriates on subsidiary performance has been an important research theme in the fields of international business and international human resource management (HRM) (Colakoglu & Caligiuri, 2008; Gaur, Delios, & Singh, 2007; Gong, 2003a). The term *expatriates* in this study refers to parent country nationals (PCNs) from MNE parent companies assigned to their foreign subsidiaries (Tan & Mahoney, 2006). As one of the most important resources of MNEs expatriates are expected to achieve a wide range of corporate objectives, including facilitating firm-specific knowledge transfer (Jensen & Szulanski, 2004; Wang, Tong, & Koh, 2004), establishing international operations and opening new markets, as well as gaining international experience. These, in turn, help MNEs obtain competitive advantage and

enhance their subsidiary performance (Delios & Beamish, 2001; Tan & Mahoney, 2006).

Although the importance of expatriates for the subsidiary performance of MNEs has been confirmed by the existing studies, extant research has overwhelmingly focused on the performance benefits of expatriates of MNEs from developed-countries. These studies are based on the assumption that the knowledge will be transferred from headquarters to subsidiaries, through expatriates positively impacts subsidiary performance (Delios & Beamish, 2001; Gong, 2003a; Tan & Mahoney, 2006). However, in the past decade, outward FDI from EMNEs has dramatically increased. EMNEs have invested heavily in both developed and developing countries, and the increasing presence of EMNEs in the global market place has raised the question as to whether the findings on the relationship between expatriates and subsidiary performance based on established MNEs can be applied to EMNEs. In particular, we know very little about the influence of internal control mechanisms through expatriation on subsidiary performance and whether such an influence is contingent on the institutional environment of host countries.

In addition, previous research on expatriation and subsidiary performance has overwhelmingly focused on the direct impact of expatriates on subsidiary performance through the lenses of Transaction-Cost Economics (TCE) (Benito, et al., 2005; Colakoglu & Caligiuri, 2008; Tan & Mahoney, 2006) and institutional theory (Xu, Pan, & Beamish, 2004) without considering the role of subsidiary autonomy. However, subsidiary autonomy plays an important role between expatriation and subsidiary

performance. First, expatriates can be regarded as an extended form of management control over overseas subsidiary by MNE parents (Boyacigiller, 1990; Egelhoff, 1984; Lorange, 1986; Steers & Nardon, 2006) and significantly affects autonomy of overseas subsidiaries. As an important internal strategic resource of MNEs, expatriates are supposed to carry out the mission of headquarters, and MNE parents may exert control over a subsidiary by adjusting the activities of expatriates in host countries (Gupta & Govindarajan, 1991). Secondly, a growing body of previous studies has shown that subsidiary autonomy is an important element of MNE strategies and is positively associated with subsidiary performance (Ambos & Birkinshaw, 2010; Gammelgaard, et al., 2012; McDonald, Warhurst, & Allen, 2008; Tran, Mahnke, & Ambos, 2010; Wang, et al., 2013). For instance, McDonald, Warhurst and Allen (2008) find that there is a positive relationship between varying degrees of subsidiary autonomy and performance. Ambos and Birkinshaw (2010) indicate that subsidiaries achieve superior performance enjoying high levels of local decision-making authority and by attracting the parent company's attention within the MNE network. Tran et al. (2010) suggest that subsidiary autonomy is an important element of MNE strategies and is positively associated with subsidiary performance. Similarly, Gammelgaard et al. (2012) present evidence that subsidiary performance is increased with subsidiary autonomy. Kawai and Strange (2014) also suggest that the appropriate balance between subsidiary internal and external factors can help a subsidiary to achieve superior performance. Wang, et al., (2013) find that subsidiary autonomy is considered as a strategic mechanism with which to overcome EMNEs' lack of experience in managing globally dispersed businesses and home-country disadvantages.



Although the effect of subsidiary autonomy on subsidiary performance has become an important theme in international HRM research (Gammelgaard, et al., 2012; Gomez & Werner, 2004; Kawai & Strange, 2014; McDonald, Warhurst, & Allen, 2008; Slangen & Hennart, 2008), the mediating role of subsidiary autonomy between expatriates and subsidiary performance has been under-explored, especially in the case of EMNEs. It is important to delineate the path from expatriates to subsidiary performance via subsidiary autonomy in host countries with different institutional environments, given that EMNEs originated in under-developed institutional environments. They may respond to the institutional environments of host countries through altering internal control systems such as expatriate staffing and subsidiary autonomy. Thus, the link between expatriates, subsidiary autonomy and subsidiary performance may be contingent on the institutional environment of a host country.

To address the research gaps, the author adopts the resource dependence perspective (Pfeffer & Salancik, 1978) to examine the following research questions: To what extent does subsidiary autonomy mediate the impact of expatriates on subsidiary performance? To what extent does host-country institutional quality moderate the relationship between expatriates and the subsidiary performance of EMNEs? The author proposes that subsidiary autonomy may act as an intermediate factor between expatriates and subsidiary performance given the institutional quality of host countries.

This chapter is structured as follows: After the brief literature review, the next section focuses on theory and hypotheses. The author then introduces the sample and variables

used in the study in Section 4.4. Section 4.5 presents the empirical results, followed by discussion of the findings. Section 4.7 concludes.

## **4.2 Literature Review**

### **4.2.1 Role of Expatriates**

In the international arena, there are two types of human resources, local and expatriate, and the latter may be from the MNE parent company or from a third country. The existing studies on expatriate staffing can be classified into several broad categories according to the nature of expatriate assignments and the reason why MNCs utilise expatriates (Edstrom & Galbraith, 1977; Novecevic & Harvey, 2004). The original classification made by Edstrom and Galbraith (1977) suggested that there are basically three company motives for the use of expatriate managers. The first motive is to fill positions that require specific skills when qualified local nationals are not available. The second motive is management development, which is concerned with giving high-potential managers international experience and preparing the person for important future tasks in subsidiaries abroad or with the parent company. The third motive is not to individual development but organisation development, and this motive infers that expatriates are used as a part of a coordination and control strategy and involve more strategy responsibilities than the previous two.

Within the growing body of literature on expatriation, a stream of research emphasises that expatriates have been conceptualised as performing two primary functions in a subsidiary (Edstrom & Galbraith, 1977; Egelhoff, 1984; Ondrack, 1985). The first is a

knowledge function. The expatriate not only plays an important role in transferring the parent firm's knowledge to the subsidiary, but also is an agent for the acquisition of host-country knowledge. The second is a control function in which the expatriate works to align the operations of the unit with that of the parent organisation.

Extant research emphasises that tacit and complex knowledge is often transferred from parent firms to subsidiaries through social interactions and the exchange process (Huber, 1991; Subramaniam & Venkatraman, 2001), and thus transferring is often completed through the use of expatriates (Teece, 1977; Wang, Tong, & Koh, 2004). In this area, expatriates are defined as individual knowledge carriers who can help improve subsidiary performance by transferring personal experience and individual knowledge, which are lacking in foreign subsidiaries (Gaur, Delios, & Singh, 2007; Minbaeva & Michailova, 2004; Tan & Mahoney, 2006). Therefore, expatriate assignment is considered as an effective means for MNE parents to increase the knowledge accumulation of their subsidiaries by transferring knowledge that is useful for their foreign operations (Bjorkman, Barner-Rasmussen, & Li, 2004; Delios & Bjorkman, 2000; Tung, 1987). For example, Tsang (2001) examines the antecedents of learning in MNEs' foreign subsidiaries and shows that expatriates play an important role in transferring knowledge to the subsidiaries. Hebert et al. (2005) indicate that the acquired firm's survival considerably depends on the type of experience which is extracted from expatriates. Following on from Hocking et al. (2007), they suggest that expatriates serve as conduits of transferring tacit knowledge about culture-specific customer preferences and expectations in host countries.

Once the knowledge that defines how things are done in the company is transferred, MNEs' subsidiaries may continue to use expatriates for the purpose of control. A number of studies argue that one of the important roles played by all expatriates is to enable MNE parents to control the subsidiaries (Black, Mendenhall, & Oddou, 1991; Delios & Bjorkman, 2000; Harzing, 2001; Tung, 1987). One commonly used approach by the headquarters to control foreign subsidiaries is to assign expatriates to work in them who will implement headquarters' policies and strategies. Harzing (2001) argues that the most distinctive role of expatriates is the implementing of 'an informal coordination and control strategy through socialisation and the building of informal communication networks', and emphasises the increasing importance of informal control mechanisms in MNEs. Following Bartlett et al. (2008), it can be argued that the use of expatriates on international assignments is to forge interpersonal links and supervise organisational cohesion with the corporate values of headquarters. Paik and Sohn (2004) demonstrate that expatriates should not only be committed to corporate values but also have high levels of cultural knowledge of the host country. Using the samples of Japanese MNEs in 4 countries (Taiwan, Singapore, Korea and the USA), they indicate that while expatriate personnel with inadequate culture knowledge of the host country are not only less effective in controlling the subsidiary but may also have damaging effects on the MNE's control.

As a summary, MNEs use expatriates for a number of reasons. It seems to provide management skills and expertise not available in the host country, to transfer firm-specific and tacit knowledge and skills, and to maintain control and organisational

identity (Bjorkman, Barner-Rasmussen, & Li, 2004; Fang, et al., 2010; Tan & Mahoney, 2006), which can influence subsidiary level outcomes such as performance.

#### **4.2.2 Subsidiary Autonomy**

A logic step forward for MNE parents is to consider the appropriate balance between their control over their foreign subsidiaries and subsidiary autonomy. Subsidiary autonomy can be defined as the degree of freedom a subsidiary obtains from the MNE parent in the decision making process on all areas that concern the subsidiary, such as strategic, functional and operational areas (O'Donnell, 2000; Taggart & Hood, 1999). It means that subsidiary managers have more managerial discretion for choosing the way to leverage firm-specific resources (e.g., knowledge, technology, finance and human capital). Bartlett and Ghoshal (1989) assess that the appropriate level of subsidiary autonomy plays an important role in managing parents-subsidiary relationships. They argue that overseas subsidiaries relying solely on their parents may find it difficult to exploit local market opportunities due to lack of local responsiveness. Similarly, Luo (2003) suggests that subsidiary independence results in the appropriate alignment of business strategies and local market conditions (i.e., customer, competitors, and legal institutions). In this regard, subsidiary autonomy is an essential issue for an MNE since appropriate levels of control could result in potential benefits for the MNE and for the subsidiary. On the one hand, there is the need for MNE parents to control subsidiary behaviour in order to ensure that the activities of subsidiaries are aligned with corporate strategy (Gates & Egelhoff, 1986; Harzing, 1999; Roth, Schweiger, & Morrison, 1991). On the other hand, subsidiaries provide access to

knowledge and ideas through their linkages with the host country and can add great value to the MNEs by participating autonomous entrepreneurial behaviour.

Although the effect of subsidiary autonomy on subsidiary performance has become an important theme in the existing IB literature, most of the existing studies have examined the direct link between subsidiary autonomy and subsidiary performance (Gammelgaard, et al., 2012; Gomez & Werner, 2004; Kawai & Strange, 2014; McDonald, Warhurst, & Allen, 2008; Newburry, Zeria, & Yeheskel, 2003; Tran, Mahnke, & Ambos, 2010; Young & Tavares, 2004). In particular, the mediating role of subsidiary autonomy in the relationship between the level of expatriates and subsidiary performance has been under-explored, especially in the case of EEMNEs. It is important to delineate the path from expatriates to subsidiary performance via subsidiary autonomy in host countries with different institutional environments, given that EEMNEs originated in under-developed institutional environments and they may respond to the institutional environments of host countries through altering subsidiary autonomy.

#### **4.2.3 Expatriates and Subsidiary Performance**

The employment of PCN expatriates to manage foreign subsidiaries may have an influence on subsidiary performance. The influence of PCN expatriates on subsidiary performance can be either positive or negative (or potentially neutral) depending on contextual factors and the fit between the staffing approach and the contextual variables. Some studies found that expatriates can transfer firm-specific knowledge to the

subsidiary, control and coordinate subsidiary operations, and hence improve subsidiary performance (Edstrom & Galbraith, 1977; Harzing, 2001; Riusala & Suutari, 2004). On the contrary, some studies find that the use of expatriates may result in interpersonal friction due to poor intercultural communication and hence reduces subsidiary performance (Gong, 2003a; Kopp, 1994). Therefore, in this study, the author does not assume a direct relationship between expatriate staffing and performance but focus on the indirect relationship which is dependent on contextual factors.

Although there has been a sizable empirical research examining the relationship between expatriate staffing and subsidiary performance, the mixed evidence that has accumulated supports the notion that we need to consider contextual factors in this relationship. For example, Konopaske et al. (2002) found support for the interactive effects of mode of entry and staffing approach on the subsidiary performance of Japanese MNCs. Specifically, they found that ethnocentric staffing in joint ventures relates negatively to subsidiary performance and ethnocentric staffing in wholly owned subsidiaries relates positively to subsidiary performance. Richards (2001), in her comparison of the subsidiaries of US MNEs in UK and Thailand, found that locally managed subsidiaries in Thailand were more successful than expatriate-run ones because of the higher cultural distance between the US and Thailand, compared to UK and US. Gong (2003a) reported that the positive impact of expatriate staffing on subsidiary performance increases with cultural distance but decreases over time as the host country learns from the parent country. Most recently, Gaur et al. (2007) found that the positive effect of expatriate staffing levels on subsidiary performance is

dependent on the institutional distance between the host and home country and subsidiary experience. Colakoglu and Caligiuri (2008) investigated the link between the use of expatriates and subsidiary performance as a function of culture distance. They found that a higher ratio of PCN expatriates is related to lower subsidiary performance, particularly in cases where cultural distance is long.

Despite a large number of studies on the relationship between expatriates and subsidiary performance as summarised in Table 4.1, there are still some research gaps. Most studies tend to focus on the role of expatriates of MNEs from developed-countries. In addition, extant research has exclusively investigated the direct impact of expatriates on subsidiary performance without considering the role of subsidiary autonomy. There is a lack of research on examining the overall relationship between expatriates, subsidiary autonomy and subsidiary performance in various institutional contexts based on a mediating and moderating model. In other words, we need a better understanding of the relationship between expatriate staffing and subsidiary performance and the contextual factors that are crucial in mediating and/or moderating this relationship. In addressing these research gaps, the mediating role of subsidiary autonomy in subsidiary performance and the moderating role of host-country institutional quality will be explored in the following sections.



**Table 4.1 Prior studies on the relationship between expatriates and subsidiary performance**

Authors (year)	Regional focus	Research method	Sample size	Theoretical perspectives	Key findings
Richards (2001)	US	Quantitative (interview)	24 manufacturing multinational headquarters, 23 UK subsidiaries, and 26 Thai subsidiaries	US No theoretical framework; economic explanation	Locally managed subsidiaries in Thailand were more successful than expatriate-run ones because of the higher cultural distance between US and Thailand, compared to the UK and US
Konopaske, Werner and Neupert (2002)	Japanese	Quantitative (Survey)	3835 subsidiaries (2102 wholly owned and 1733 joint ventures) from 48 Japanese industries in 31 different countries	No theoretical framework: rationale based on theories of a firm's resource profile	Ethnocentric staffing in joint ventures relates negatively to subsidiary performance and ethnocentric staffing in wholly owned subsidiaries relates positively to subsidiary performance
Gong (2003a)	Japanese	Quantitative (Survey)	400 subsidiary top management teams (TMT) with a total of 2,506 top managers from 28 Japanese MNEs	Agency theory and RBV	A positive effect of expatriate staffing on subsidiary performance increases with culture distance but decreases over time
Beechler et al. (2004)	Japanese	Quantitative (Survey)	119 Japanese subsidiaries in the US (41) and Europe (78)	Functional/Contingency approach	Overall subsidiary performance is negatively related to expatriate staffing (non-significant results);

Gong (2006)	Japanese	Quantitative	370 STMTs of 28 Japanese MNE throughout the world with a total of 2290 top managers	Upper echelon theory	In the European subsample an increase in the percentage of expatriates is significantly negatively related to performance.
Gaur, Delios and Singh (2007)	Japanese	Quantitative	12,997 subsidiaries of 2,952 Japanese firms in 48 countries	Institutional theory	STMT nationality heterogeneity has a positive impact on subsidiary performance; Subsidiary age moderates this relationship such that the positive influence is stronger for subsidiaries with more years of operation.
Colakoglu and Caligiuri (2008)	US	Quantitative (Survey)	Wholly-owned US subsidiaries of 52 multinational corporations	Transaction costs theory	The positive influence (subsidiary labour productivity) is dependent on the institutional distance between the host and home country, and subsidiary experience
Wang, Tong, Chen and Kim (2009)	China	Quantitative (Survey)	242 subsidiaries	RBV; international strategy	A high ratio of parent country expatriates is related to lower subsidiary performance, particularly in cases where culture distance is high.
Kaeppli (2009)	Japanese	Quantitative (Survey)	64 wholly owned Swiss subsidiaries in Japan	Functional approach	Using expatriates with motivation and adaptability for knowledge transfer improved subsidiary performance; Using expatriates with technical skills only indirectly improves subsidiary performance via the knowledge transferred to the subsidiary.
					Well performing subsidiaries have less than 15% of expatriates and their managers are well in their 50s and have worked in Japan for more than 10 years, with experience in different Japanese companies.

Colakoglu, Tarique and Caligiuri (2009)	Japanese	Quantitative (Survey)	N/A (theoretical paper)	RBV	PCN staffing will lead to a higher subsidiary performance within the MNC than HCN or TCN staffing as PCNs have more social capital within the MNC; The relationship between subsidiary staffing and host market performance depends on the environmental contingencies around the subsidiaries.
Fang et al. (2010)	Japanese	Quantitative	1660 foreign subsidiaries of Japanese MNCs (50.3% in Asia, 22.4% in North America, 21.9% in Europe, RoW 5.4%)	RBV	The ratio of expatriates in a foreign subsidiary positively supports the impact the parent companies' technological knowledge has on the subsidiaries short-term performance; The ratio of expatriates in a foreign subsidiary negatively moderates the relationship between the parent companies level of marketing knowledge and the subsidiaries' long-term performance.
Bebenroth and Li (2010)	Japanese	Quantitative	643 foreign subsidiaries in Japan from all over the world mainly from the US, UK, Switzerland, Germany and France	Functional approach, agency theory	Foreign subsidiaries in Japan perform statistically significant better when having a foreign CEO and having a higher ratio of expatriated managers on the subsidiary board.

Sekiguchi, Bebenroth and Li (2011)	Japanese	Quantitative	643 subsidiaries in Japan (215 PCN, 428 HCN; 40.4% in TMT) from 31 countries	foreign in PCN, Upper echelon theory	Knowledge-based view, Upper echelon theory	Young subsidiaries perform better under PCN management; Larger subsidiaries among younger ones perform better when the proportion of PCNs in the TMT is rather large than small.
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## **4.3 Theory and Hypotheses**

### **4.3.1 Theoretical Background**

The extant literature has used multiple theories to examine the optimal level of expatriates, such as institutional theory (Xu, Pan, & Beamish, 2004), TCE (Benito, et al., 2005; Colakoglu & Caligiuri, 2008; Tan & Mahoney, 2006) and resource-based view (Tan & Mahoney, 2006). The findings from existing studies have enhanced our understanding of the importance of expatriates in MNEs' overseas operations. However, these studies have paid little attention to the impact of expatriates on subsidiary autonomy (Aharoni, Tihanyi, & Connelly, 2011) and how EMNEs respond to external uncertainty through adjusting their internal management strategies (Davis & Cobb, 2010), such as localisation (Lu, et al., 2014; Yildiz & Fey, 2012) and parental support (Feinberg & Gupta, 2009; Luo, 2003). The Resource Dependence Theory (RDT) has been increasingly influential as a theoretical basis for international business research. For example, Lewin et al. (2004) suggest that the RDT is a particularly appropriate approach to account for the dynamic relationship between an MNE parent and its subsidiaries. Thus, this study takes an overarching theoretical view of RDT to examine the indirect impact of expatriates on subsidiary performance via subsidiary autonomy.

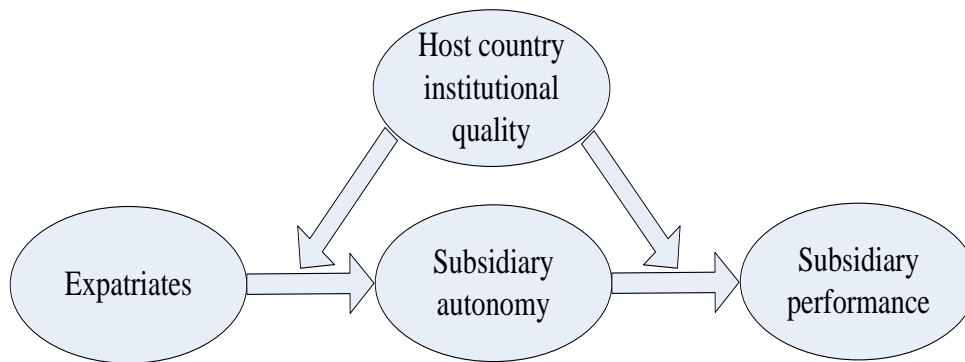
RDT considers the behaviour aspect of firms and explains the importance of intra and inter-organisational behaviour based on power relationships (Pfeffer & Salancik, 1978). According to RDT, a host country is endowed with scarce resources needed by MNE subsidiaries (Cui, Meryer, & Hu, 2014; Moran, 1985), and a dependency situation arises

when MNE subsidiaries rely on irreplaceable resources controlled by local resource holders (Pfeffer & Salancik, 1978). In particular, when local institutions are underdeveloped, MNE subsidiaries face increasing risk and uncertainty due to ambiguous regulations and perhaps an unstable government. In order to decrease the risk or transaction costs associated with resource acquisition, an MNE subsidiary can reduce its dependence on local resources by utilizing more internal resources from its parent (Kobrin, 1982). This internal flow may consist of not only physical resources but also knowledge and human resources (Gupta & Govindarajan, 1991). Thus, the improvement of resource support from MNE parents may help reduce the external dependency of the subsidiaries.

Expatriates constitute an important internal resource within MNEs and the utilisation of expatriates influences the parent-subsidiary relationship (Fang, et al., 2010). An MNE parent may assign expatriates to the subsidiary as a specific governance mechanism (Gong, 2003). This internal control mechanism helps ensure a subsidiary's compliance with the parent company's organisational values and operational priorities (Belderbos & Heijltjes, 2005; Boyacigiller, 1990). In addition, expatriates can play a key role in facilitating the transfer of firm-specific tacit and complex knowledge from a parent to its subsidiary, particularly for recently established foreign subsidiaries (Delios & Bjorkman, 2000; Wang, et al., 2009). Through the formal communication channel and the informal socialisation mechanism, expatriates can identify, access and bring relevant parent knowledge to the subsidiary (Edstrom & Galbraith, 1977). This knowledge may include a corporate culture, a management style and ways of

conducting business that create causal ambiguity and barriers to transfer and imitation (Simonin, 1999). Therefore, an MNE parent will have substantial control over its subsidiary through the usage of expatriates. The subsidiary in turn will rely on its parent for resources and knowledge to minimise risk and external dependence in host countries with low quality institutions. This suggests that expatriates may serve as an internal control mechanism for an MNE parent and affect subsidiary autonomy, which in turn may impact on subsidiary performance (McDonald, Warhurst, & Allen, 2008). This implies that the effect of expatriates on organisational outcomes is more complex than the existing literature suggests. Therefore, this study focuses on the indirect impact of expatriates on subsidiary performance via subsidiary autonomy.

As shown in Figure 4.1, the author proposes that expatriates have a negative impact on subsidiary autonomy, and a reduction in subsidiary autonomy leads to a decrease in subsidiary performance. Furthermore, institutional quality in the host country positively moderates the first link (i.e. the relationship between expatriates and subsidiary autonomy), but negatively moderates the second link (i.e. subsidiary autonomy and subsidiary performance) in the mediation relationship. In other words, subsidiary autonomy mediates the relationship between expatriates and subsidiary performance, given the institutional quality of the host countries. Taken together, the author proposes a moderated mediation model to capture the complex relationships between expatriates, subsidiary autonomy and subsidiary performance, given different levels of institutional quality.



**Figure 4.1 The conceptual framework**

### **4.3.2 A Mediating Role of Subsidiary Autonomy**

Subsidiary autonomy is a complex concept (Young & Tavares, 2004) which is commonly defined as the extent to which a subsidiary has the authority to make decisions with a degree of independence from the MNE parent (Brooke, 1984; Nell & Andersson, 2012; O'Donnell, 2000). If a subsidiary can make decisions on main value activities, such as HRM, procurement, marketing and sales (Browman, Duncan, & Weir, 2000; Edwards, Ahmad, & Moss, 2002), and enjoy higher levels of decision-making power for these value activities (Newburry, Zeria, & Yeheskel, 2003), it will have more autonomy.

A growing body of existing literature has established that subsidiary autonomy serves as a mechanism for management control, which affects subsidiary performance (Ambos



& Birkinshaw, 2010; Gammelgaard, et al., 2012; McDonald, Warhurst, & Allen, 2008; Tran, Mahnke, & Ambos, 2010; Wang, et al., 2013). However, very little research has systematically examined the relationship between expatriates and subsidiary autonomy, as well as the question of whether the autonomy granted to a foreign subsidiary will mediate the relationship between expatriates and subsidiary performance.

The author proposes that in addition to the direct impact of expatriates on subsidiary performance, there may be an indirect impact of expatriates on subsidiary performance via subsidiary autonomy. Drawing upon the RDT, expatriates, as a valuable internal human resource, are considered a common mechanism in subsidiary control in reducing the external dependence outside MNEs (Chalos & O'Connor, 2004). Assigning expatriates is an important way for the headquarters to exercise its power (Gupta & Govindarajan, 1991). In order to process a substantial amount of information regarding subsidiary operating protocols, an MNE parent usually assigns expatriate managers whose function will be to increase the channels of communication between the parent company and the subsidiary, which guarantees that the parent company's interests are well represented within the subsidiary (Boyacigiller, 1990). Expatriates and subsidiary autonomy are closely related to each other. As expatriates can be considered an extended form of headquarters control and supervision (Boyacigiller, 1990; Egelhoff, 1984; Lorange, 1986; Steers & Nardon, 2006), subsidiary autonomy will become lower when the level of expatriates is higher.

On the other hand, a reduction in subsidiary autonomy will reduce subsidiary performance due to more limited access to valuable external resources which can be

available locally in the host countries. Extant research shows that subsidiary autonomy granted by MNE parents has a positive impact on subsidiary performance (Gammelgaard, et al., 2012; Gomez & Werner, 2004; McDonald, Warhurst, & Allen, 2008). Most existing research has argued that less autonomy will discourage the subsidiary from fostering a higher level of organisational learning (Luo, 2003), reduce parent-subsidiary cooperation (Birkinshaw, et al., 2000), block knowledge creation (Young & Tavares, 2004) and hinder strategic leadership initiatives (Birkinshaw, Hood, & Jonsson, 1998). All of these reduce competitive advantage and decrease subsidiary performance. More importantly, a lower level of autonomy may block or represent barriers in the access to complementary external resources in host countries. For example, the operational costs will be significantly increased where companies do not work with local suppliers and embed subsidiaries within the local supply network (Fan, Nyland, & Zhu, 2008; Rangan & Drummond, 2011). The subsidiaries with limited autonomy find it difficult to bond and cooperate with local businesses without the involvement of local managers and employees who have better knowledge of local market environments than expatriates (Law, et al., 2009; Selmer, 2004). This will in turn negatively influence subsidiary performance.

In summary, the author argues that subsidiary autonomy will mediate the impact of expatriates on subsidiary performance. Expatriates not only transfer firm-specific knowledge to the subsidiary, but also tend to result in more control from the parent company, thus leading to a lower level of subsidiary autonomy, which in turn is associated with a lower level of subsidiary performance. Adopting RDT logic,

subsidiary autonomy serves as an intermediate mechanism through which expatriate resources assigned by the MNE parents can affect subsidiary performance. Therefore, departing from the existing research in this domain, the author posits a mediation path that moves beyond the direct impact of expatriates on subsidiary performance. That is, using expatriates can enable the parent company to have tighter control on subsidiaries and thus reduce subsidiary autonomy, which in turn leads to a decrease in subsidiary performance. Hence, the author hypothesis:

**Hypothesis 1:** Subsidiary autonomy mediates the relationship between expatriates and subsidiary performance in that the level of expatriates has a negative impact on subsidiary autonomy, and a reduction in subsidiary autonomy leads to a decrease in subsidiary performance.

#### **4.3.3 The Moderating Role of Host-country Institutional Quality**

The institutional quality of host countries has long been identified as an important factor affecting MNE subsidiary performance (Luo & Tung, 2007). It refers to the degree of stability and development of the institutional infrastructure of host countries, which includes the set of laws, regulations, administrative procedures and policies formally sanctioned by the government (Cuervo-Cazurra & Genc, 2008; Delios & Henisz, 2003). The existing research reveals that knowledge is more likely to be learned and obtained from a host country with well-established institutions where effective institutional protection can be provided for foreign firms operating there (Berry, 2006; Buckley, et al., 2010; Luo & Tung, 2007). EMNEs that lack international managerial expertise,

international market knowledge and advanced technology may be able to acquire these strategic assets when their subsidiaries are located in host countries with well-developed institutions. Local firms in these host countries are more likely to possess strategic resources needed by EMNEs, but such resources are not usually available in the EMNEs' domestic markets or in other emerging markets (Nicholson & Salaber, 2013). The asset-seeking behaviour of EMNEs may reduce the dependence of their subsidiaries on headquarters in such host countries (Lu, et al., 2014). This in turn may reduce the need for expatriates compared to those subsidiaries in host countries with underdeveloped institutions which offer limited opportunities for knowledge exploration. The reduced level of expatriates also lessens the control from the corporate parent. This implies that higher autonomy may be achieved by a subsidiary located in those host countries with high institutional quality, thereby gaining access to strategic resources and advanced knowledge available locally, and hence reducing transaction costs. Thus, the negative relationship between expatriates and subsidiary autonomy will be reinforced in those host countries with well-established institutions.

In contrast, when host-country institutions are underdeveloped, the institutional environment tends to be risky (Wang, et al., 2013). EMNEs operating within such an environment are subject to increasing external uncertainty and decreasing credibility (Agarwal & Ramaswami, 1992; Akhter & Lusch, 1998; Delios & Beamish, 1999; Delios & Henisz, 2000; Henisz, 2000). According to RDT, a subsidiary relies more on internal resources and knowledge transferred from MNE headquarters in order to replace inter-organisational resource exchanges (Feinberg & Gupta, 2009). Expatriates

can be used as an internal resource to reduce the external dependence when facing uncertainty stemming from an unstable external environment. Thus, an increasing level of expatriates may become a pragmatic response strategy when EMNE subsidiaries operate in such host countries (i.e. those with institutional ambiguities, underdeveloped markets and ineffective enforcement of regulations) (Wright, et al., 2005). When uncertainty in business activities is high in a host country, centralised subsidiaries are unlikely to overcome the frequent changes and unknowns inherent in environmental uncertainty, due to a high level of bureaucracy in the decision making process and coordination costs associated with a high level of centralisation (Bartlett & Ghoshal, 1989). This implies that extra autonomy needs to be granted to respond promptly to frequent changes resulting from increasing external uncertainty. As a result, an increase in expatriates from headquarters may lead to a disproportionate decrease in subsidiary autonomy when subsidiaries operate in an underdeveloped institutional environment, given that subsidiaries in such an environment need more internal resource exchange and a higher level of subsidiary autonomy to respond to institutional voids. Hence, the author proposes:

**Hypothesis 2:** Host-country institutional quality will influence the negative impact of expatriates on subsidiary autonomy such that the negative relationship between expatriates and subsidiary autonomy is stronger in host-countries with high institutional quality than those with low institutional quality.

Institutional quality in host countries not only moderates the link between expatriates and subsidiary autonomy, but also the relationship between subsidiary autonomy and subsidiary performance. Since institutions are developed to create order and a stable environment, and to promote economic exchange and cooperation (North, 1990; Williamson, 1985), host-country institutions affect subsidiaries in accessing and sharing external resources and knowledge (Meyer & Sinani, 2009). Well-established institutions are able to provide an efficient common infrastructure and reduce transactional uncertainty (McEvily & Zaheer, 1999). Foreign subsidiaries operating in host countries with high institutional quality can easily follow ‘the rules of the game’ and gain the information necessary for effective operations (Schwens, Eiche, & Kabst, 2011). In addition, well-developed market-supporting institutions may help subsidiaries reduce search costs associated with accessing critical knowledge and resources for foreign operations. This indicates that political risks and uncertainty are relatively low in host countries with well-developed institutions, so the importance of subsidiary autonomy for subsidiary performance may be reduced when operating in such a context. This implies that a high level of subsidiary autonomy may not be a necessary condition for achieving desirable performance.

On the other hand, under-developed institutions generate hazards of expropriation and transactional uncertainty, and so subsidiaries have to rely on greater autonomy to deal with political and operational risks, and thus subsidiary autonomy has a more positive impact on subsidiary performance when it is flexible and responds to the frequent changes and instability of the host-country government. An ‘agile’ approach with

regard to local decision making may be necessary in order to cope with frequent decision making cycles. Such a mechanism can help to ensure effective operations, thus enhancing subsidiary performance. Extant research shows that uncertainty in a turbulent environment strengthens the positive relationship between autonomy and subsidiary profitability (Andersen, 2005; Kawai & Strange, 2014). This suggests that the positive impact of subsidiary autonomy on subsidiary performance will be stronger in host countries with underdeveloped institutions.

Furthermore, a lack of effective communication infrastructure could be a major obstacle preventing EMNE headquarters from being able to remotely control subsidiaries in developing host countries with low institution quality. A significant global digital divide has been observed between developed and developing countries; for example, it has been estimated that less than 1% of Africans have access to broadband data connections (Pingdom, 2008). Common business communication methods, including reliable teleconferencing, email and e-chat, are sometimes difficult to establish between headquarters and subsidiaries. Thus, granting more power to subsidiaries operating in the developing host countries with weak institutions and under-developed infrastructure becomes not simply more important but is a strategic necessity compared to those in the developed host countries with high institutional quality. Our arguments above lead to the following hypothesis.

**Hypothesis 3:** Host-country institutional quality will influence the positive impact of subsidiary autonomy on subsidiary performance such that the positive

relationship between subsidiary autonomy and subsidiary performance is stronger in host countries with low institutional quality than those with high institutional quality.

## **4.4 Methodology**

### **4.4.1 Sample and Data Collection**

The data used to test the hypotheses was collected with support from the Asia Pacific Foundation of Canada (APFC) and the China Council for the Promotion of International Trade (CCPIT). The former is an independent non-governmental organisation focusing on Canada's relations with Asia, whereas the latter is a national non-government organisation for the promotion of foreign trade in China. Collaboration with the CCPIT enabled us to access its members through its local representatives who are familiar with these enterprises, and thus encourage participation in the survey (Liu, et al., 2015). Conducting surveys through local research networks and onsite personal meetings proved to be best practice in obtaining reliable and valid information in emerging economies such as China (Zhou, Tse, & Li, 2006; Zhu, et al., 2008). Previous surveys on China's outward FDI conducted by the CCPIT and APFC have been widely cited (Luo, Xue, & Han, 2010; Tung, 2007; UNCTD, 2006).

On the basis of a thorough literature review, the questionnaire was originally prepared in English and then, with the assistance of an independent translator, translated into Chinese. Following Hoskisson, et al. (2000), a back-translation technique was used to examine the accuracy of the survey content. The author also conducted four in-depth interviews with CCPIT officials who were familiar with companies involved in outward



FDI to cross-check questionnaire items and terminology, and to ratify the content and validity of our measurements. The questionnaire was modified based on their feedback. In the pilot testing, the questionnaire was sent to ten senior managers who were in charge of outward FDI and whose companies were CCPIT members. The questionnaire was further revised based on their feedback.

The sample of Chinese companies was randomly selected from the CCPIT's membership enterprises that have registered their outward FDI activities with the Ministry of Commerce People's Republic of China (MOFCOM). The original sample consisted of 2000 companies. The CCPIT's local representatives contacted these companies first, and then sent hard copies of the questionnaires to the general managers of the chosen companies. Of the 2000 questionnaires mailed out, a total of 365 questionnaires were received by the headquarters of CCPIT in Beijing, corresponding to a response rate of 18.25%. A comparison of the locations and industries between the responding firms and non-responding ones suggested two groups of firms have similar distribution patterns in both industries and location. 20 respondents were randomly selected and then were contacted via phone calls to verify that the questionnaires had been completed by senior managers who were familiar with their company's internationalisation activities. After excluding the responses which either had missing information or were inapplicable, the author left with 181 observations. For example, the author excluded the firms operating abroad mainly through setting up export agencies or foreign wholly-owned subsidiaries in China, given that the latter companies may have structure and operational processes that may not be compatible with Chinese

companies (Yiu, Lau, & Bruton, 2007). Our final sample size is 181, including 45 SOEs and 136 private firms. These firms operate in 14 industries and have invested in 49 countries. The detailed information on subsidiary location is presented in Table 4.2.

**Table 4.2 The location of Chinese subsidiaries overseas**

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Investment Destinations: host countries
Algeria, Australia, Austria, Bengal, Brazil, Botswana, Burkina Faso, Cambodia, Canada, Congo, Ecuador, Equatorial Guinea, Ethiopia, France, Gabon, Germany, Ghana, Guinea, Hungary, Iran, India, Indonesia, Japan, Kazakhstan, Kenya, Kyrgyzstan, Laos, Malaysia, Mongolia, Mozambique, Netherlands, Nigeria, Peru, Philippines, Russia, Saudi Arabia, Singapore, South Africa, South Korea, Sudan, Tanzania, the UK, the USA, Turkey, Uganda, Ukraine, United Arab Emirates, Uzbekistan, Vietnam

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#### **4.4.2 Variables and Measures**

##### **Dependent variables**

Following previous studies (Brouthers & Xu, 2002; He, Tian, & Chen, 2007; Lu, et al., 2010), a perceptual measure was used to proxy the performance of overseas subsidiaries of Chinese MNEs. Some researchers (He, Tian, & Chen, 2007; Woodcock, Beamish, & Makino, 1994) indicated that perceptual measures are appropriate when (1) companies are either unwilling or unable to provide sensitive accounting data; (2)

variations in accounting approaches across countries are likely to hinder the reconciliation of differences; and/or (3) there are strong enough fluctuations in exchange rates between home and host countries. As a widely used construct in previous studies (Andersson, Forsgren, & Holm, 2002; Birkinshaw, Hood, & Young, 2005; He, Tian, & Chen, 2007; Lu, et al., 2010), perceptual measures of performance have been proven to possess strong internal consistency and reliability (Cooper & Artz, 1995; Ketokivi & Schroeder, 2004).

The respondents were asked to evaluate the performance of their newly established overseas subsidiaries. This focus presents a number of advantages. First, respondents can be more able to differentiate the focal overseas subsidiary from other overseas subsidiaries, and thus enhance the reliability of this measure. Second, all other key independent variables, i.e. expatriates, host country institutional quality and subsidiary autonomy, are directly related to the focal overseas subsidiary. Thus, the dependent variable and the key independent variables are compatible and focused on the same overseas subsidiary.

The variable consisted of three items on a seven-point scale (1=very dissatisfied; 7=very satisfied): (1) growth rate of sales; (2) growth rate of market share; and (3) growth rate of profit in the overseas subsidiary. The confirmatory factor analysis showed that the three items were loaded on a single factor, explaining 83.81% of the total variance. Cronbach's alpha reliability for perceived subsidiary performance was 0.90, which is greater than 0.60, a commonly acceptable level of reliability (Nunnally, 1978).

## **Independent variables**

Based on Gong (2003a), Konopaske, et al. (2002) and Boyacigiller (1990), the level of expatriates is measured as the percentage of expatriates in the total workforce. In the survey instrument, the expatriate percentage was calculated by dividing the number of expatriates in a subsidiary by the total number of employees in the subsidiary. Traditionally, expatriates are considered individuals of any national origin who are transferred outside their home country (Edstrom & Galbraith, 1977; Hocking, Brown, & Harzing, 2004). In the context of Chinese MNEs, expatriates are considered synonymous with individuals of Chinese nationality who work outside China (Belderbos & Heijltjes, 2005). According to Boyacigiller's (1990) terminology, the author uses the terms *expatriate* and *parent-country national* synonymously in the case of Chinese MNEs. Thus, the term, an expatriate, is considered to be synonymous with PCN and a non-expatriate is considered to be synonymous with Host-Country National (HCN).

## **Mediating variables**

The author followed Williams and van Triest (2009) and assessed the level of autonomy based on the respondents' assessment regarding how much autonomy their management team was given to manage the subsidiary in terms of strategic and operational decision-making authority. Based on the evaluation and the practical insight of the managers from our pilot study, subsidiary autonomy is measured by four items along a seven-point scale (1=low; 7=high). The items are related to whether subsidiary

managers have the authority to (1) decide the scope of their operations; (2) make budgetary and financial decisions; (3) hire, reward, promote and fire employees; and (4) undertake merger, acquisition and other capital operations. The factor analysis showed that the four items converged into a single factor, explaining 72.58% of the total variance. Cronbach's alpha for the measure was 0.87.

### **Moderating variables**

Based on previous studies (Cuervo-Cazurra & Genc, 2008; Slangen & Tulder, 2009), the objective measurement of the *World Governance Indicators (WGI) in 2010* was used to capture the institutional quality of the host country. The WGI reports aggregate and individual governance indicators for 215 economies over the period 1996-2013 includes six dimensions of government: (1) voice and accountability; (2) political stability and absence of violence; (3) government effectiveness; (4) regulatory quality; (5) rule of law and (6) control of corruption. We aggregated the six dimensions and labelled it as a company's institutional quality. As each dimension has been constructed by compiling a number of primary and secondary data sources, the index offers reliable and comprehensive proxies for empirical studies (Oh & Oetzel, 2011). The values of the WGI were rescaled by adding 2.5 so that the values in our sample range from 0 (low institutional quality) to 5 (high institutional quality), which helped facilitate the interpretation for the statistical significance of this variable (Cuervo-Cazurra & Genc, 2008). The items were loaded on a single factor, explaining 84.59% of the variance. The reliability of the measurement was acknowledged with a Cronbach's coefficient alpha of 0.92.

Table 4.3 lists the measurement items above and summarises the confirmatory factor analysis and internal consistency of the scales.

**Table 4.3 Measurement scales and factor loadings**

Constructs	Measurement items	Factor loading	Variance explained (%)	Cronbach's alphas
Subsidiary performance CR=0.89, AVE=0.74	<ul style="list-style-type: none"> <li>• Sale growth</li> <li>• Local market share growth</li> <li>• Sales margin growth</li> </ul>	0.84 0.90 0.83	83.81	$\alpha=0.90$
Subsidiary autonomy CR=0.88, AVE=0.64	<ul style="list-style-type: none"> <li>• Right to decide the scope of operations by heads of overseas subsidiary</li> <li>• Right to decide budgetary and financial decisions by heads of overseas subsidiary</li> <li>• Right to hire, reward, promote and fire employees by heads of overseas subsidiary</li> <li>• Right to do mergers and acquisitions and other capital operations by overseas subsidiary</li> </ul>	0.82 0.87 0.87 0.63	72.58	$\alpha=0.87$
Institutional quality CR=0.96, AVE=0.81	<ul style="list-style-type: none"> <li>• Voice and Accountability</li> <li>• Political Stability and Absence of Violence/Terrorism</li> <li>• Government Effectiveness</li> <li>• Regulatory Quality</li> <li>• Rule of Law</li> <li>• Control of Corruption</li> </ul>	0.73 0.81 0.96 0.95 0.97 0.94	84.59	$\alpha=0.92$

CR, composite reliability; AVE, average variance extracted

## **Control variables**

Several variables that may also affect subsidiary performance were controlled. First, the author included a measure of subsidiary age, which was calculated as the number of years of operations within a host country (Delios & Beamish, 2001; Fey & Furu, 2008). Second, an MNE parent's age and size were included as control variables. They were calculated as the number of years in business and the natural logarithm of the number of employees, respectively (Van-Wijk, Jansen, & Lyles, 2008; Zhou, Wu, & Luo, 2007). Third, because parent ownership types also matter in a transition economy (Wu & Lin, 2010), the author differentiated parent company types: state-owned enterprises and private-owned companies. A dummy variable with a value of 1 indicates that the parent company is a state-owned enterprise, and a value of 0 indicates a private-owned company. Finally, the author created dummy variables to control for the industry sector in which a subsidiary locates.

### **4.4.3 Common Method Bias**

As much of the data was collected from the same survey respondents, there may exist the potential for the occurrence of common method variance (Krishnan, Martin, & Noorderhaven, 2006). The author took a number of steps to minimize common method bias. First, multiple item constructs were used in our survey, since response biases are more likely to occur at the item level rather than at the construct level. In particular, the mediating and moderating effect is included in our hypotheses. This approach is effective in controlling for the issue of common method variance because complex



relationships between the dependent and independent variables are not part of the respondents' theory-in-use (Chang, Witteloostuijn, & Eden, 2010). Second, following previous studies (Antonakis, Bendahan, & Jacquart, 2010; Kemery & Dunlap, 1986; Podsakoff & Organ, 1986; Richardson, Simmering, & Sturman, 2009), the author performed Harman's single factor test. This test is one of the widely used techniques to diagnose CMV. All the variables in the study are loaded into an exploratory factor analysis to see whether one single factor does emerge or whether one general factor does account for a majority of the covariance among the variables. From the table 4.4, it can be seen from the first row that the Harman's single factor technique estimates the common method variance to be 42.6% which is less than the commonly accepted threshold of 50% (Eichhorn, 2014). This suggests that CMV is not of a great concern with this dataset. Third, the level of expatriates, as an independent variable, is a formative value rather than a self-perceived measure. In addition, the author also used an objective measure for the institutional quality of host countries. Taken together, the potential extent of common method variance has been reduced substantially.

**Table 4.4 Results of Harman's single factor test**

	Eigenvalue	Difference	Proportion	Cumulative
1	5.53395	2.05449	0.4257	0.4257
2	3.47946	1.98185	0.2677	0.6933
3	1.49761	0.92083	0.1152	0.8085
4	0.57678	0.15851	0.0444	0.8529
5	0.41827	0.04211	0.0322	0.8851
6	0.37616	0.09656	0.0289	0.9140
7	0.27960	0.04713	0.0215	0.9355
8	0.23247	0.01915	0.0179	0.9534
9	0.21333	0.02593	0.0164	0.9698
10	0.18739	0.09586	0.0144	0.9842
11	0.09153	0.02266	0.0070	0.9913
12	0.06887	0.02429	0.0053	0.9966
13	0.04458	-	0.0034	1.0000

## 4.5 Empirical Results

The mean, standard deviations and correlations of the variables used in our analysis are presented in Table 4.5. It is shown that all correlations among the independent variables are fairly low. To avoid potential multicollinearity, the author centred the variables and computed the interaction terms as a product of the centred scores on the component variables in all analyses. Control variables were included in all regression analyses unless specified otherwise. To assess potential multicollinearity, the Variance Inflation Factors (VIFs) of the matrices of independence variables and covariates were computed (Neter, Wasserman, & Kutner, 1990). The result of the VIF test, reported in Table 4.6, shows that none of the VIF values exceed the threshold of 10 and indicates that multicollinearity is not a concern.

**Table 4.5 Descriptive statistic and correlations**

Variables	Mean	s.d.	1	2	3	4	5	6	7	8	9
1. MNC parent age	20.17	15.09	1.00								
2. Subsidiary age	5.18	2.88	0.03	1.00							
3. MNC parent size	2.81	0.92	0.41**	0.02	1.00						
4. Parent ownership	0.25	0.43	0.31**	-0.03	0.07	1.00					
5. Subsidiary industry	0.25	0.43	0.07	0.17*	0.19*	-0.07	1.00				
6. Subsidiary performance	4.48	1.01	0.06	0.07	0.26**	-0.11	0.19**	1.00			
7. Expatriates	46.37	35.17	0.12	-0.09	0.12	0.18*	-0.04	-0.13	1.00		
8. Subsidiary autonomy	4.53	1.15	-0.01	0.04	0.15*	-0.14	0.24**	0.43**	-0.15*	1.00	
9. Institutional quality	2.93	0.98	-0.07	0.13	-0.31**	0.01	-0.13	-0.22**	-0.07	-0.10	1.00

N=181. Mean and standard deviations for MNC parent age, subsidiary age, MNC parent size, parent ownership, subsidiary industry and expatriates are based on raw data.

\*p<0.05; \*\*p<0.01

**Table 4.6 Variance Inflation Factor test**

<b>Variable</b>	<b>VIF</b>	<b>1/VIF</b>
MNC parent age	1.30	0.7665
MNC parent size	1.29	0.7780
Parent ownership	1.17	0.8515
Subsidiary industry	1.15	0.8729
Subsidiary autonomy	1.10	0.9064
Institutional quality	1.08	0.9224
Expatriates	1.07	0.9353
Subsidiary age	1.06	0.9391
Mean VIF		1.15

A moderated mediation model can be tested in a number of ways (Edwards & Lambert, 2007; MacKinnon, et al., 2002; Shrout & Bolger, 2002). The author follows Edwards and Lambert's (2007) procedure which integrates moderated regression analysis and path analysis to comprehensively analyse simultaneous moderation and mediation. This includes the first stage (between expatriates and subsidiary autonomy), the second stage (between subsidiary autonomy and subsidiary performance), a direct relationship between expatriates and subsidiary performance and an indirect effect through subsidiary autonomy, as well as the total effect at a particular level of the moderator (institutional quality).

Therefore, in this study, the author tested the hypothesis on the mediating effects of subsidiary autonomy on the relationship between expatriates and subsidiary performance based on Edwards and Lambert's constrained nonlinear regression module (Edwards & Lambert, 2007). A first and second-stage moderated mediation model is involved in estimating the following two equations:

$$\mathbf{M} = \alpha_{05} + \alpha_{X5}X + \alpha_{Z5}Z + \alpha_{XZ5}XZ + \varepsilon_{M5} \quad (1)$$

$$\mathbf{Y} = \beta_{020} + \beta_{X20}X + \beta_{M20}M + \beta_{Z20}Z + \beta_{XZ20}XZ + \beta_{MZ20}MZ + \varepsilon_{Y20} \quad (2)$$

Where X is expatriates; Z is institutional quality; XZ is the product of expatriates and institutional quality; M is a subsidiary autonomy; MZ is the product of subsidiary autonomy and institutional quality; and Y is subsidiary performance.

Equation 3 is obtained by substituting Equation 1 into Equation 2:

$$Y = [\beta_{020} + \beta_{Z20}Z + (\alpha_{05} + \alpha_{Z5}Z)(\beta_{M20} + \beta_{MZ20}Z)] + [(\beta_{X20} + \beta_{XZ20}Z) + (\alpha_{X5} + \alpha_{XZ5}Z)(\beta_{M20} + \beta_{MZ20}Z)]X + \varepsilon_{Y20} + \beta_{M20}\varepsilon_{M5} + \beta_{MZ20}Z\varepsilon_{M5} \quad (3)$$

In Equation 3, the direct effect of X (expatriates) on Y (subsidiary performance) corresponds to the term  $(\beta_{X20} + \beta_{XZ20}Z)$ , which varies by Z (institutional quality). The indirect effect of X on Y corresponds to  $(\alpha_{X5} + \alpha_{XZ5}Z)(\beta_{M20} + \beta_{MZ20}Z)$ , which also varies by Z. The term  $(\alpha_{X5} + \alpha_{XZ5}Z)$  captures the first-stage moderation of the indirect effect, and the term  $(\beta_{M20} + \beta_{MZ20}Z)$  captures the second-stage moderation of the indirect effect.

**Table 4.7 Coefficient estimates for the moderated mediation model for subsidiary performance**

	First stage (dependent variable = SA)						Second stage (dependent variable = performance)					
	Module 1			Module 2			Module 3			Module 4		
	$\alpha$	SE	t	$\alpha$	SE	t	$\alpha$	SE	t	$\alpha$	SE	t
Subsidiary age	0.00	0.03	0.00	0.00	0.03	-0.03	0.08	0.02	1.12	0.07	0.02	1.12
MNC parent age	0.06	0.01	0.74	0.04	0.01	0.51	0.03	0.00	0.46	0.02	0.00	0.26
MNC parent size	-0.02	0.08	-0.28	-0.03	0.08	-0.39	0.10	0.07	1.42	0.09	0.07	1.34
Parent Ownership	-0.12	0.17	-1.52	-0.10	0.17	-1.47	-0.07	0.14	-1.07	-0.07	0.14	-1.07
Subsidiary industry	0.23	0.18	2.97**	0.23	0.18	3.30**	0.04	0.14	0.59	0.05	0.14	0.82
Expatriates	-0.15	0.00	-2.02*	0.19	0.00	2.74**	-0.07	0.00	-1.03	0.11	0.00	1.75
Institutional quality	-0.09	0.08	-1.21	0.07	0.08	0.97	-0.22	0.06	-3.10**	0.04	0.06	0.66
Subsidiary autonomy							0.43	0.08	5.08**	0.51	0.08	6.03**
Expatriates x institutional quality				-0.37	0.00	-5.11**				-0.20	0.00	-3.10**
Subsidiary autonomy x institutional quality										-0.19	0.01	-2.94*
R <sup>2</sup>		0.10			0.24			0.26			0.38	
Adjusted R <sup>2</sup>		0.06			0.21			0.23			0.35	

Note: N=181; SA=subsidiary autonomy; SE=standard error.

\*p<0.05; \*\*p<0.01;

Hypothesis 1 suggests that subsidiary autonomy mediates the relationship between expatriates and subsidiary performance, in which expatriates negatively affect subsidiary autonomy and a reduction in subsidiary autonomy leads to a decrease in subsidiary performance. Table 4.7 presents the regression results of Hypothesis 1. The first-stage effect of expatriates on subsidiary autonomy in Model 1 is significantly negative ( $\beta=-0.15$ ,  $p<0.05$ ), whereas the second-stage effect of subsidiary autonomy on subsidiary performance in Model 3 is positive and significant ( $\beta=0.43$ ,  $p<0.01$ ). Furthermore, the direct effect of expatriates on subsidiary performance appears to be insignificant ( $\beta=-0.07$ ,  $p>0.10$ ). Therefore, there is a full, indirect-only mediation rather than a partial mediation (Zhao, Lynch, & Chen, 2010) which indicates that the level of expatriates affects subsidiary autonomy but does not affect subsidiary performance directly. Therefore, subsidiary autonomy fully mediates the relationship between expatriates and subsidiary performance. This is confirmed by a Sobel's test (Sobel, 1982), which is significant ( $z=-5.37$ ,  $p<0.01$ ). Consequently, Hypothesis 1 is supported.

In model 3, the direct effect of the host country institutional quality on subsidiary performance is also tested. The coefficient of host country institutional quality is negative and significant ( $\beta=-0.22$ ,  $p<0.01$ ), which indicates that the host country institutional quality has an impact on the subsidiary performance.

The results in Model 2 and Model 4 show that the institutional quality of host countries positively moderates the negative impact of expatriates on subsidiary autonomy, but negatively moderates the positive impact of subsidiary autonomy on subsidiary performance. Thus, the author receives support for Hypothesis 2 and Hypothesis 3.

**Table 4.8 The effects of the relationship between expatriates and subsidiary autonomy and between subsidiary autonomy and subsidiary performance at different levels of institutional quality**

Model	Institutional quality	First stage	Second stage
E-SA-Performance	Low	0.55*	0.70*
	High	-0.17*	0.32*
	Difference	0.72*	0.38*

Note. N=181. The first and second-stage simple effects for low and high levels of institutional quality were calculated with coefficient estimates from Table 4.5. Institutional quality were +0.98 (i.e., one SD above the mean) and -0.98 (i.e., one SD below the mean) for the high and low levels of institutional quality, respectively. Differences in simple effects were calculated by subtracting the effects for high institutional quality from the effects for low institutional quality. Significant tests for the first and second-stage simple effects are equivalent to tests for the coefficients of the interaction terms in the first and second-stage model in Table 4.7, respectively.

E = expatriates; SA = subsidiary autonomy.

\*p<0.05; \*\*p<0.01

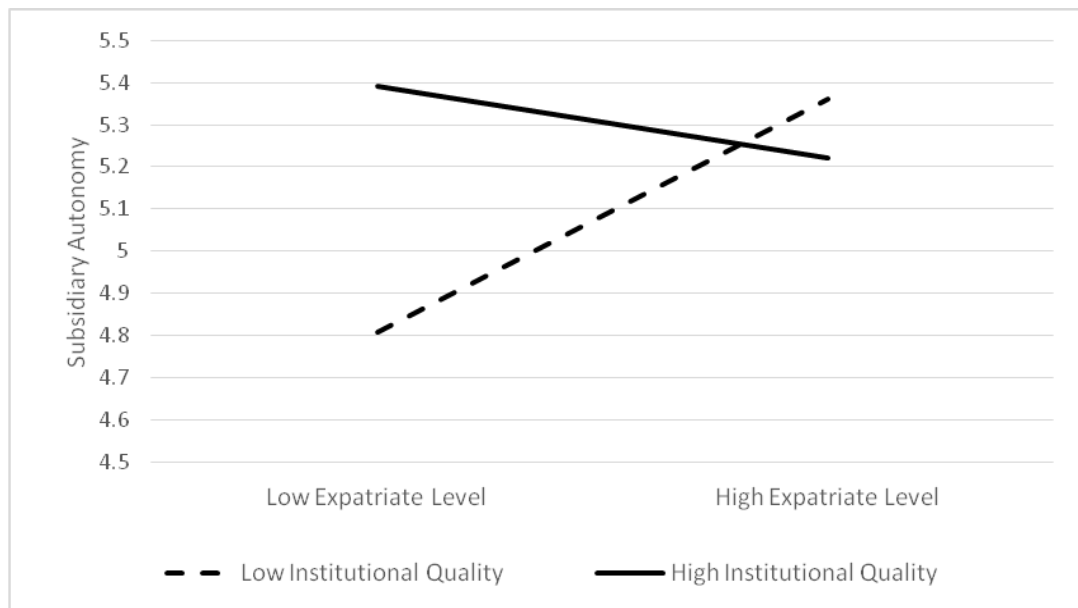


Table 4.8 summarises the results of further testing Hypothesis 2 and Hypothesis 3. One standard deviation above or below the mean is used to indicate a high or low level of host-country institutional quality (Aiken & West, 1991) which shows the interrelationship between expatriates, subsidiary autonomy and subsidiary performance at different levels of institutional quality. The first-stage moderation, which applies to the first-stage of the indirect effect, was significant ( $0.55 - (-0.17) = 0.72$ ,  $p < 0.05$ ). The results indicate that the first-stage effect was 0.55 ( $p < 0.05$ ) in the host countries with a low level of institutional quality and -0.17 ( $p < 0.05$ ) at the high level of host-country institutional quality. Thus, the results further confirm hypothesis 2, which suggests that the negative relationship between expatriates and subsidiary autonomy is stronger when institutional quality is high. The second-stage moderation, which applies to the second stage of the indirect effect, was significant ( $0.70 - 0.32 = 0.38$ ,  $p < 0.05$ ). The second-stage effect was 0.70 ( $p < 0.05$ ) in the host countries with a low level of institutional quality and 0.32 ( $p < 0.05$ ) at a high level of institutional quality. The results further support Hypothesis 3, which proposes that the positive relationship between subsidiary autonomy and subsidiary performance is stronger when institutional quality is low.

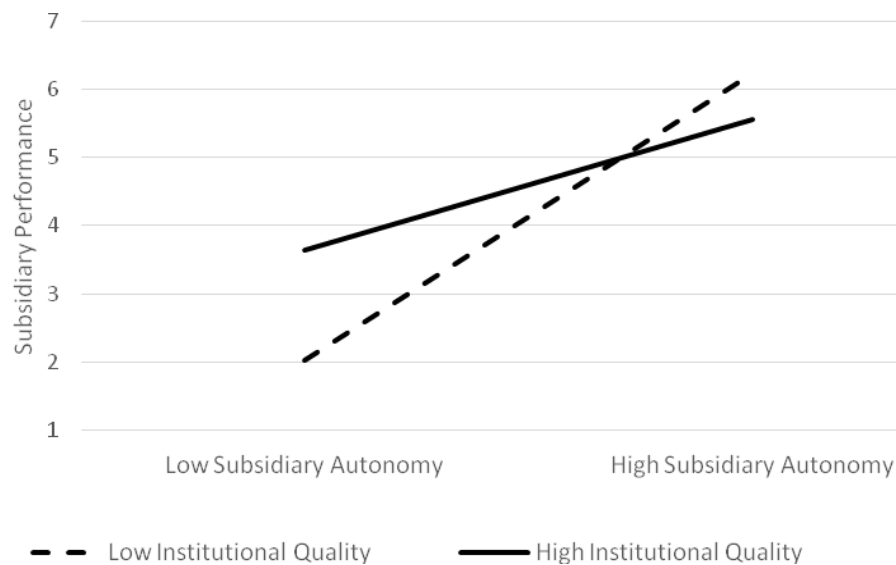
In order to have a better understanding on how institutional quality moderates the relationship between expatriates and subsidiary autonomy, and between subsidiary autonomy and subsidiary performance, the author plotted the interaction effects in Figures 4.2 and 4.3. As shown in Figure 4.2, a high level of expatriate staffing is associated with a low level of autonomy in conditions of high host-country institutional quality. In Figure 4.3, it can be seen that greater autonomy is related to a high level of

subsidiary performance in the host countries with low institutional quality. Both Figure 4.2 and Figure 4.3 further support Hypothesis 2 and Hypothesis 3 respectively.

**Figure 4.2 The effect of expatriates on subsidiary autonomy in the host countries with high and low levels of institutional quality**



**Figure 4.3 The effect of subsidiary autonomy on subsidiary performance in the host countries with high and low levels of institutional quality**



In summary, the author finds that the level of subsidiary autonomy mediates the relationship between expatriates and subsidiary performance. In addition, the results also show that the effect of expatriates on subsidiary autonomy and the impact of subsidiary autonomy on subsidiary performance are moderated by host-country institutional quality.

## **4.6 Discussion**

Based on a sample of Chinese MNEs, the author has examined whether subsidiary autonomy mediates the impact of expatriates on subsidiary performance, and have considered the moderating effect of the institutional quality of host countries on the mediation mechanism. Our findings show that subsidiary autonomy, to a large extent, serves as a key mediator in the relationship between expatriates and subsidiary

performance. By assigning expatriates to a subsidiary, the MNE parent may grant less autonomy to the subsidiary, which in turn reduces subsidiary performance. In other words, the power relationship between a subsidiary and its parent will shift toward the subsidiary when the level of expatriates decreases. The results differ from those of the majority of previous studies which reported a direct relationship between expatriation and subsidiary performance (Gaur, Delios, & Singh, 2007; Gong, 2003a; Richards, 2001).

The author further examined the interrelationship between expatriates, subsidiary autonomy and subsidiary performance given different levels of institutional quality. The findings indicate that the level of expatriates is used as a strategic control and resource exchange mechanism by EMNEs. Specifically, high quality institutions in host countries induce EMNE parents to send fewer expatriates, which results in a high level of subsidiary autonomy. This suggests that subsidiaries are motivated to engage in asset exploration in those host countries by granting them a high level of autonomy. There may be more resource exchange between subsidiaries and local firms in host countries with well-established institutions. Thus, the negative relationship between expatriates and subsidiary autonomy is reinforced in host countries with high institutional quality. When subsidiaries are located in host countries with a high institutional quality, they may be able to employ more local employees and engage more closely with local suppliers and clients. The findings also suggest that the impact of expatriates on subsidiary autonomy and subsidiary performance varies depending on host-country institutional quality. The nature of strategic asset-seeking outward FDI from emerging

economies is also reflected in the relationship between the corporate parents and subsidiaries. When EMNE subsidiaries operate in developed host countries with well-established institutions, they tend to establish a decentralised organisational structure which facilitates knowledge access and knowledge acquisition. For example, Lenovo acquired IBM's PC division in 2004, and in the meantime appointed IBM's Senior Vice President, Steve Ward, as the first foreign senior executive of the PC division of Lenovo in order to maintain knowledge access and customer acceptance (Luo & Tung, 2007).

In contrast, the link between expatriates and subsidiary autonomy is reversed from negative to positive in host countries with lower institutional quality. Our findings suggest when subsidiaries operate in a host country with a high level of uncertainty and risk, they rely on both expatriates and subsidiary autonomy to respond to the frequent changes and to counterbalance the impact of the risky environment. This implies that a subsidiary is granted more autonomy when institutional quality in the host countries is low. The findings suggest that EMNEs are likely to use more expatriates in countries with low institution quality compared to those in countries with high institution quality. Thus, the level of expatriates not only acts as an internal control mechanism but also as a means of intra-organisational or internal resource exchange between the MNE parent and subsidiary when external resource exchanges are unreliable and subject to high transaction costs due to greater uncertainty in the host countries. Subsidiaries operating in a host country with low institutional quality need to have additional autonomy and extra expatriates from headquarters. As such, they are able to use intra-organisational resource flows to reduce their external dependence on local staffing. This finding also

indicates the importance of investigating the moderating effect of institutional quality. EMNEs are sensitive to local institutional quality and are very flexible in their response. EMNE parents support their subsidiaries in lower institutional quality countries with a higher level of expatriates and give them autonomy to run local subsidiaries according to the local environment, whereas in countries with higher institutional quality, parental firms tend to use a lower level of expatriates which leads to a higher level of autonomy.

Our findings show that there is a substitution effect between subsidiary autonomy and host-country institutional quality on subsidiary performance. The higher autonomy will enable effective local decision making to quickly respond to dynamic market changes and absorb the uncertainty in the countries with low institutional quality. Autonomous local decision making is more important in the host countries with low institutional quality where a lack of well-developed communication infrastructure makes it difficult for EMNE headquarters to remotely control and coordinate their subsidiaries. This study reveals that Chinese MNEs tend to assign more expatriates and grant more autonomy to the subsidiaries located in the countries with low institutional quality in order to enhance subsidiary performance.

## **4.7 Summary**

Adopting the resource dependence perspective, this paper examines the indirect effects of expatriates via subsidiary autonomy on subsidiary performance, and is based on a sample of Chinese MNEs operating in 49 countries. The author finds that assigning more expatriates enables parent companies to have tighter control on subsidiaries and

reduce their autonomy, which in turn leads to a decrease in subsidiary performance. The results show that subsidiary autonomy mediates the relationship between expatriates and subsidiary performance. Such a relationship is moderated by host countries' institutional quality. The institutional quality of host countries reinforces the negative impact of expatriates on subsidiary autonomy, but reduces the importance of the latter on subsidiary performance. By examining the moderating effect of host-country institutional quality, this study sheds new light on the contingency of the institutional environment of a host-country and EMNEs' subsidiary performance. Thus, our study advances research on the post-entry organisational structure of EMNEs by providing new insights into the role of expatriates and subsidiary autonomy as mechanisms of external dependence reduction and knowledge exploration in host countries with different institutional qualities.

## **5. Conclusion**

This chapter concludes the major findings and contributions of the thesis, as well as the practical implications for managers and policy makers. It also acknowledges the research limitations, and points out possible future research. This chapter consists of four sections. Section 5.1 summarises the main findings of this study. Section 5.2 reviews the major contributions of this study. Section 5.3 outlines implications to managers and policy makers. Finally, section 5.4 discusses limitations and proposes possible future studies.

### **5.1 A Summary of the Main Findings**

This thesis looks at the performance implications of the internationalisation of Chinese firms. Given that China's outward FDI has become one of the major contributors to the world FDI outflows and its increasing power in the world economy, this thesis provides a timely assessment by examining the short-term impact of cross-border M&As by Chinese firms on their stock market performance (Chapter 2), investigating the long-term impact of such M&As on their post-acquisition operating performance (Chapter 3), and inspecting whether certain management strategies can improve the performance of overseas subsidiaries (Chapter 4).



### **5.1.1 The Main Findings based on the Short-term Stock Market Performance Study**

Chapter 2 discovers the conditions under which cross-border M&As create shareholder value for Chinese acquirers based on signalling theory and the institution-based view. The results show that cross-border M&As by Chinese acquirers are interpreted by investors in the stock market as strong signals released by Chinese firms resulting in a significant and positive stock market reaction. M&A activities by Chinese firms symbolise these Chinese firms' financial confidence and global ambitions, and are perceived as a spring board to acquire strategic resources and capabilities from a global market in order to seize opportunities to enhance their competitive advantage.

The findings also show that there are asymmetric market reactions to cross-border M&As by Chinese firms in the Mainland Chinese stock markets and the Hong Kong stock market. Divergent market reactions in Hong Kong and Mainland China reflect the institutional arrangements of 'one country, two systems' across China. The Mainland Chinese stock markets behave differently from the Hong Kong stock market. The former exhibits good-news-chasing behaviour which results in more significant reactions to the same M&A events than those in the Hong Kong stock market.

Moreover, the results indicate that the shareholders of Chinese firms acquiring target firms in host countries with low levels of political risk gain higher cumulative abnormal returns than those firms targeting the countries with high levels of political risk. Chinese cross-border M&As benefit from a stable investment environment with well-established institutions in target countries with a low level of political risk. This

indicates that cross-border M&As enable Chinese acquirers to span national boundaries to obtain strategic assets and credibly enhance their global reputation (Siegel, 2009), thus causing positive market reactions.

Finally, the author finds that cross-border M&As have different performance implications for acquiring firms with different ownership structures. The shareholders of Chinese state-owned enterprises experience lower abnormal returns compared with those of Chinese privately-owned firms when engaging in cross-border M&A activities. This finding indicates the hidden relationship between the ownership structure and market performance of cross-border M&As - the shareholders of Chinese SOE acquirers earn a lower level of abnormal returns than those of private acquirers.

### **5.1.2 The Main Findings based on the Long-term Operating Performance Study**

Chapter 3 analyses whether cross-border M&As initiated by Chinese firms in different destinations influence their operating performance. Drawing on the organisational learning and the institution-based view, this study investigates the long-term impact of cross-border M&As, initiated by Chinese firms, on their operating performance. Based on a sample of Chinese firms during the period 2000-2012, the findings show that cross-border M&As tend to improve the post-acquisition operating performance of Chinese acquiring firms with serial acquisitions and horizontal acquisitions. These imply that the prior knowledge learned through past experience of cross-border M&As plays a crucial role in identifying the value of external knowledge in target firms and enhancing

post-acquisition integration and synergy, which results in better post-acquisition performance in cross-border M&As.

By examining how different country-level characteristics moderate the value creating effects of acquisitions, the results indicate that the positive effects of serial acquisitions and horizontal acquisitions on the post-acquisition performance of Chinese acquirers are stronger for cross-border M&As taking place in host countries with high institutional quality. High-quality knowledge is more likely to be obtained from host countries with high institutional quality. Acquiring a target company located in a country with high institutional quality represents a quick way to gain access to superior knowledge and resources which usually are not available in the closed domestic market in China and therefore positively moderates the effect on post-acquisition performance of Chinese acquiring firms.

The author finds that the positive effects of serial cross-border M&As and horizontal cross-border M&As on the post-acquisition performance of Chinese acquiring firms are stronger for cross-border M&As taking place in Chinese speaking regions/countries. This indicates that language difference is a significant barrier for effective communications especially when target firms are from non-Chinese speaking regions/countries during the process of post-acquisition integration and synergy. While target firms are from Chinese speaking regions/countries, the common language will facilitate organisational learning between Chinese acquirers and overseas target firms which will positively strengthen the effect on the post-acquisition performance of Chinese firms.

### **5.1.3 The Main Findings based on the Overseas Subsidiary Performance Study**

Chapter 4 investigates whether different management strategies can enhance the performance of overseas subsidiaries. Drawing on the RDT, this study examines the indirect effects of expatriates on subsidiary performance via subsidiary autonomy. The findings show that an increase in expatriates reduces the level of subsidiary autonomy and thus negatively affects subsidiary performance. Subsidiary autonomy, to a great extent, serves as an important mediator of the link between expatriation and subsidiary performance. By assigning more expatriates to an overseas subsidiary, the MNE parent may grant less autonomy to the subsidiary, which in turn reduces subsidiary performance. In other words, the power relationship between an overseas subsidiary and its parent will shift toward the side of the overseas subsidiary when the level of expatriates decreases.

In addition, this study finds that the institutional quality of host countries reinforces the negative influence of expatriates on subsidiary autonomy. The findings indicate that the level of expatriates is used as a mechanism for strategic control and resource exchange by EMNEs. More specifically, high quality institutions in host countries induce EMNE headquarters to send fewer expatriates, which in turn results in a high level of subsidiary autonomy. This means when subsidiaries are located in host countries with high institutional quality, the subsidiaries may be able to employ more local employees and engage more closely with local suppliers and customers. In such cases, the EMNEs tend to establish a decentralised organisational structure to facilitate knowledge access and acquisition. In contrast, the relationship between expatriation and subsidiary autonomy

is reversed from negative to positive in host countries with a lower level of institutional quality. Our research results show that when subsidiaries operate in a host country with a high level of uncertainty and risk, the overseas subsidiaries will be more dependent on both expatriates and less subsidiary autonomy in adapting to the frequent changes and absorbing the influence of the risky external environment.

Finally, the findings indicate that there is a substitution effect between subsidiary autonomy and host-country institutional quality on subsidiary performance. The higher autonomy enables effective local decision making to quickly adapt to dynamic market changes and counterbalance the uncertainty in the countries with low levels of institutional quality. Autonomous local decision making by overseas subsidiaries is more important in the host countries with low levels of institutional quality where a lack of well-developed communication infrastructure makes it difficult for EMNE parents to remotely control and timely coordinate their overseas subsidiaries. This thesis also reveals that Chinese MNEs tend to send higher levels of expatriates and grant higher autonomy to the subsidiaries located in the countries with low institutional quality in order to improve subsidiary performance.

## **5.2 Research Contributions**

### **5.2.1 The Contributions based on the Short-term Stock Market Performance Study**

This study on short-term stock market performance contributes to the existing literature in three main ways. First, unlike previous studies, the author integrates the signalling

theory and the institution-based view to examine the short-term performance implications of Chinese cross-border M&As, and unpack what is behind such activities. The findings from our study provide new insights into cross-border M&A value generation through market reactions and the extent to which short-term market performance reflects investors' perception on the institutional characteristics of M&A events. Although it is well documented that Chinese firms use cross-border M&As as a strategic means of acquiring valuable technology, brands and managerial capability, there is a lack of evidence on the market reactions to this important strategic approach. The study thus adds much needed evidence on the link between market reactions and the unique institutional characteristics embedded in cross-border M&As by Chinese firms.

Second, this study takes a first step towards investigating the impact of the institutional setting of the financial markets on market reactions to cross-border M&As by revealing the different magnitudes of such reactions under 'one country, two systems'. The findings imply that the short-term market performance of cross-border M&As by Chinese firms is contingent on the development of the capital market. Investors in less developed capital markets may overestimate the positive impact of cross-border M&As.

Third, this study explicitly evaluates the impact of various types of political risks on market reactions to cross-border M&As by Chinese firms. Political stability and governance quality are two important components of political risks. By delineating political risk into different components, the research provides new insights into the link between different dimensions of political risks, and stock market reactions to M&A

announcements, and fills a research gap, given that there is a lack of research in this area. Additionally, the author captures the impact of the ownership of the acquiring firms and contributes to a better understanding of the impact of ownership status on the short-term performance of cross-border M&As from an institutional perspective. SOEs represent a product of the Chinese institutional environment, and their M&A activities are perceived differently compared with privately owned firms, thus resulting in different short-term market performance. Therefore, the study further reveals the impact of the institutional dimension embedded in the ownership status of Chinese acquiring firms.

### **5.2.2 The Contributions based on the Long-term Operating Performance Study**

By examining the long-term performance implications of cross-border M&As, this thesis makes several contributions to the existing literature in this area. Firstly, the author developed a new unified multilevel framework to help interpret the influence of internal factors and external factors on the post-acquisition performance of Chinese EMNEs across the firm-, industry- and country-levels by combining organisational learning and an institution-based view. This framework adds to the existing literature in the area of M&As and can be used to analyse the impact of cross-border M&As on the long-term operating performance of acquiring firms from emerging economies.

Secondly, the author identified the important moderating role of host-country institutional quality on the relationship between acquirers' experience and the post-acquisition performance of the acquiring firms as well as between the targets' industrial

relatedness and post-acquisition performance. The study is one of the first to investigate institutional conditions under which acquirers' experience and target firms' industrial relatedness affect post-acquisition performance and add much needed empirical evidence on the effects of the moderating role of host-country institutional quality.

Thirdly, this study is the first to investigate the moderating role of language on the interrelationship of acquirers' experience and targets' industrial relatedness on the post-acquisition performance of acquiring firms. The findings enhance our understanding of the mechanisms through which the effect of language, an important informal institution, on operating performance of cross-border M&As is realised and thus fills an important research gap. The findings shed new light on the importance of language ability in post-acquisition integration and synergy.

### **5.2.3 The Contributions based on the Overseas Subsidiary Performance Study**

The study on overseas subsidiary performance makes several contributions to the existing literature. Firstly, unlike previous studies which emphasised the effects of expatriates on performance in isolation, this study examines interconnection between expatriates, subsidiary autonomy and subsidiary performance. Such an investigation enables us to provide new insights into how EMNEs resolve the tension between expatriates and subsidiary autonomy in achieving desirable performance. The findings improve our understanding of the mechanisms through which the effect of expatriates on subsidiary performance is realised and thus fill an important research gap, given that



much research in this domain has mainly focused on the direct link between expatriates and subsidiary performance.

Secondly, while previous studies have predominantly focused on expatriates moving either from developed country MNEs to other developed countries or to developing countries (Colakoglu & Caligiuri, 2008; Gaur, Delios, & Singh, 2007; Gong, 2003a), few have examined the role of expatriates from EMNEs in a variety of host countries with diverse institutional qualities (Turcan & Juho, 2012). The study fills this gap by investigating the adaptive subsidiary control strategies of Chinese MNEs that have rapidly invested in both developed and developing host countries. The findings provide new insights into the contingent impact of host-country institutional quality on the links between expatriates, subsidiary autonomy and subsidiary performance.

Finally, this study is one of the first to investigate the indirect relationship between expatriates and subsidiary performance, taking account of the mediating role of autonomy granted to the subsidiary and the moderating role of the institutional quality of host countries. It extends the extant literature on the subsidiary performance of EMNEs and provides much needed evidence on the complex relationship between expatriates, subsidiary autonomy and subsidiary performance, given the institutional quality of the host countries. In particular, the findings enrich our understanding of how EMNEs, in the early stage of internationalisation, adjust the number of expatriates and subsidiary autonomy to achieve overseas success in a variety of host countries.

## **5.3 Policy and Managerial Implications**

### **5.3.1 Implications from the Short-term Stock Market Performance Study**

First, the research shows that the announcement of cross-border M&As by Chinese firms results in a positive stock market reaction which is more significant in the mainland China markets than in the Hong Kong market. This suggests that policy makers need to design appropriate regulations and further develop the capital market to avoid good-news-chasing behaviour by removing ownership restrictions, currency control and liquidity restrictions. Establishing a well-functioning capital market can reduce the dramatic volatility of market reactions to cross-border M&As by Chinese firms.

Second, the research draws attention to an important factor - political risk within target countries - which affects the market reaction to cross-border M&As. China's increased presence in Africa and other developing countries has raised concerns due to the high levels of political risk. The findings confirm the negative impact of political risk on market reactions to cross-border M&As, and thus suggest that Chinese investors should be aware of the detrimental impact of political risk when acquiring target firms from those host countries. Therefore, Chinese managers who deal with cross-border M&As should take political risk seriously to reduce their vulnerability and minimise loss when things go wrong. For policy makers of target countries, an improvement in the overall political environment is required when attracting future Chinese investment as firms

may become cautious when making M&A decisions in order to avoid a negative market reaction.

Third, the findings from our research provide useful guidance not only for Chinese acquiring firms that are expanding globally, but also for overseas target firms who are looking for buyers or investors in a bi-directional selection process. The findings show that the shareholders of Chinese SOE acquirers experience lower cumulative abnormal returns than those of Chinese private acquirers when engaging in cross-border M&As. Therefore, overseas target firms who are seeking buyers from emerging markets should keep in mind that state ownership may influence the financial market investors' reactions.

### **5.3.2 Implications from the Long-term Operating Performance Study**

The findings have a number of managerial implications for practitioners. First, the results show that firms with serial cross-border M&As perform better than those with first-time cross-border M&As. Therefore, Chinese firms should be more cautious in their first cross-border M&A deals. Professional personnel and organisations with abundant prior experience of cross-border M&As could be involved in both pre-acquisition assessment and post-acquisition integration and synergy.

Second, the research draws attention to an important factor – institutional quality of target countries, which affects the post-acquisition operating performance. The positive effect of serial cross-border M&As and horizontal acquisitions on post-acquisition performance of Chinese acquiring firms will be stronger in the host countries with high

institutional quality. The findings confirm the positive impact of institutional quality on the post-acquisition performance. Therefore, host-country institutional quality is an important factor that EMNE managers should consider in selecting potential targets in cross-border M&As. Chinese acquirers who require superior managerial expertise, international market knowledge and advanced patent-protected technology may be able to acquire these strategic assets through horizontal acquisitions in host countries with high quality institutions.

Third, the author found that the positive effect of serial cross-border M&As and horizontal acquisitions on post-acquisition performance of Chinese acquiring firms will be stronger in Chinese speaking regions/countries. The language barriers for effective communication should not be ignored in the post-acquisition integration and synergy, especially when acquirers are from a country like China with only 0.73% English speakers. Other Chinese speaking regions/countries could be a good ‘springboard’ for acquirers from mainland China to expand globally. The research finding, from the other side, also reflects the limited foreign language ability of Chinese EMNEs, which could be an obstacle for future expansion in non-Chinese speaking countries. In-house language training and recruitment of returnees (Liu, Lu, & Choi, 2014) could be potential solutions to mitigate this language obstacle problem.

### **5.3.3 Implications from the Overseas Subsidiary Performance Study**

The findings have a number of managerial implications for practitioners. First, the evidence shows that subsidiary autonomy is an important mediator linking expatriates

and subsidiary performance. Because of the negative relationship between expatriates and subsidiary autonomy, and the positive relationship between subsidiary autonomy and performance, foreign subsidiaries will be able to achieve a higher level of performance when they are granted a high level of autonomy. This implies that EMNE parents should adopt a light touch approach by delegating their subsidiaries more power and authority for decision making to achieve overseas success.

Second, the author has found that the relationship between expatriates, subsidiary autonomy and performance varies depending on host country institutional quality. Therefore, host-country institutional quality is an important factor that EMNE managers should consider in determining a suitable level of expatriate personnel. In other words, different institutional environments require a different balance of expatriates and subsidiary autonomy. Subsidiaries should be granted more autonomy with an increasing level of expatriates from headquarters when investing in host countries with under-developed institutions, but fewer expatriates and a higher level of autonomy when operating in host countries with high institutional quality.

In addition, the author found that subsidiary autonomy relates more positively to subsidiary performance when institutional quality is lower, rather than higher. This suggests that EMNEs should consider granting a higher level of subsidiary autonomy to the subsidiary as this can reduce a subsidiary's logistic costs and therefore increase efficiency. Subsidiary autonomy could be adopted as a strategic response to environmental uncertainty in those host countries with low institutional quality. EMNE managers should understand the importance of autonomy and flexibility when their

subsidiaries are operating in an environment with a high uncertainty and political risk. They need to pay particular attention to intra-firm resource exchange and reducing organisational rigidity and external dependence.

## **5.4 Research Limitations and Further Research Recommendations**

The research limitations should be acknowledged, considering reliability and validity issues, which point to avenues for future research.

First, the study focuses on outward FDI undertaken by Chinese firms. Therefore, the findings may be specific to the research setting in the context of Chinese firms' internationalisation. Future research should extend the sample to other emerging economies, such as India, Brazil, Russia and South Africa. A comparative study using different countries of origin would help verify whether the findings are idiosyncratic to the Chinese context.

Second, due to data availability, only publicly listed firms have been investigated when investigating the performance implications of cross-border M&As in Chapters 2 and 3. Future research should consider non-listed Chinese firms in order to generate a more complete picture of performance implications on the internationalisation of Chinese firms.

Third, this thesis has mainly evaluated the impact of differences in China's stock markets, political risk and ownership structure on the short-term performance of cross-

border M&As by Chinese firms when investigating the short-term implication of cross-border M&As on stock market performance in Chapter 2. In particular, the author has used fine-grained measures to capture different dimensions of political risk. However, other factors, including the characteristics of shareholders, a firm's industry, the state of management, unfavourable exchange rates, and the broad economic conditions of a host country and the home country can also affect market reactions. This represents a promising avenue for future studies.

Fourth, a perceptual measure of subsidiary performance is used in this study when investigating the implication on overseas subsidiary performance in Chapter 4. Further work could use objective measurements to evaluate the effect of expatriates on the different dimensions of subsidiary performance. In addition, expatriates are heterogeneous and vary in terms of skills and ability (Zhang & Fan, 2014). Future research is needed to further test whether different types of expatriates affect subsidiary performance indirectly via subsidiary autonomy in host countries with different institutional environments.

Lastly, the study only tested one mediator and one moderator, namely subsidiary autonomy and the institutional quality of host countries when investigating the implications of overseas subsidiary performance in Chapter 4. Future studies could examine whether other factors, such as knowledge transfer and cultural distance, also serve as mediating and moderating mechanisms. Doing so will further expand our understanding of the complex relationship between expatriation and subsidiary performance.

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## **Appendix: Survey Items**

### **Dependent variable:**

*Subsidiary performance (seven-point scale with very dissatisfied/very satisfied anchors).*

- (1) Sale growth
- (2) Local market share growth
- (3) Sales margin growth

### **Independent variable:**

*Expatriate percentage: The proportion of domestic staff send to their overseas subsidiary.*

### **Mediating variable:**

*Subsidiary autonomy (seven-point scale with very low/very high anchors).*

- (1) Right to decide the scope of operations by heads of overseas subsidiary
- (2) Right to decide budgetary and financial decisions by heads of overseas subsidiary
- (3) Right to hire, reward, promote and fire employees by heads of overseas subsidiary
- (4) Right to mergers and acquisitions and other capital operations by overseas subsidiary

### **Moderating variable:**

*Institutional quality (5 point scale with low quality/high quality anchors).*

- (1) Voice and Accountability
- (2) Political Stability and Absence of Violence/Terrorism
- (3) Government Effectiveness
- (4) Regulatory Quality
- (5) Rule of Law
- (6) Control of Corruption

**Control variables:**

*Subsidiary age:* Number of the years since the subsidiary was established

*Parent's age:* Number of the years in business

*Parent's size:* Number of employees (logged)

*Ownership:* A dummy variable that equals 1 if the MNC parent is a state-owned enterprise

*Industry:* A dummy variable that equals 1 if subsidiary locates in the manufacturing industry