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An Analysis of Factors Influencing Crossborder Acquisitions and its Implications For India

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Abstract: Growth of cross border mergers and acquisitions activity has led to increased interest in international expansion literature. Several macroeconomic, financial and institutional factors have been mentioned in literature which affect investment flows from one country to another. The objective of this paper is to examine the impact of drivers of capital flow such as macroeconomic, financial, institutional and cultural factors on the value of cross border mergers and acquisitions between different country pairs during the year 2015. A gravity model framework has been applied to understand the characteristics of the countries involved in the deals. The study finds that deal value is positively impacted by the gross domestic product of the acquirer and target and also the stock market capitalization of the acquirer. Common language also has a positive impact on deal value. Law and order in the target country, distance between the acquirer and target country and contiguity do not have significant impact. Deal value is negatively influenced by the power distance between acquirer target pairs and the masculinity v/s femininity measure index. The study highlights the implications for India and its role in the cross border deal environment, especially, after the “Make in India” campaign by the policy makers which might instil a change in desired macroeconomic and institutional environment.

Keywords: Cross border mergers and acquisitions, gravity model, India

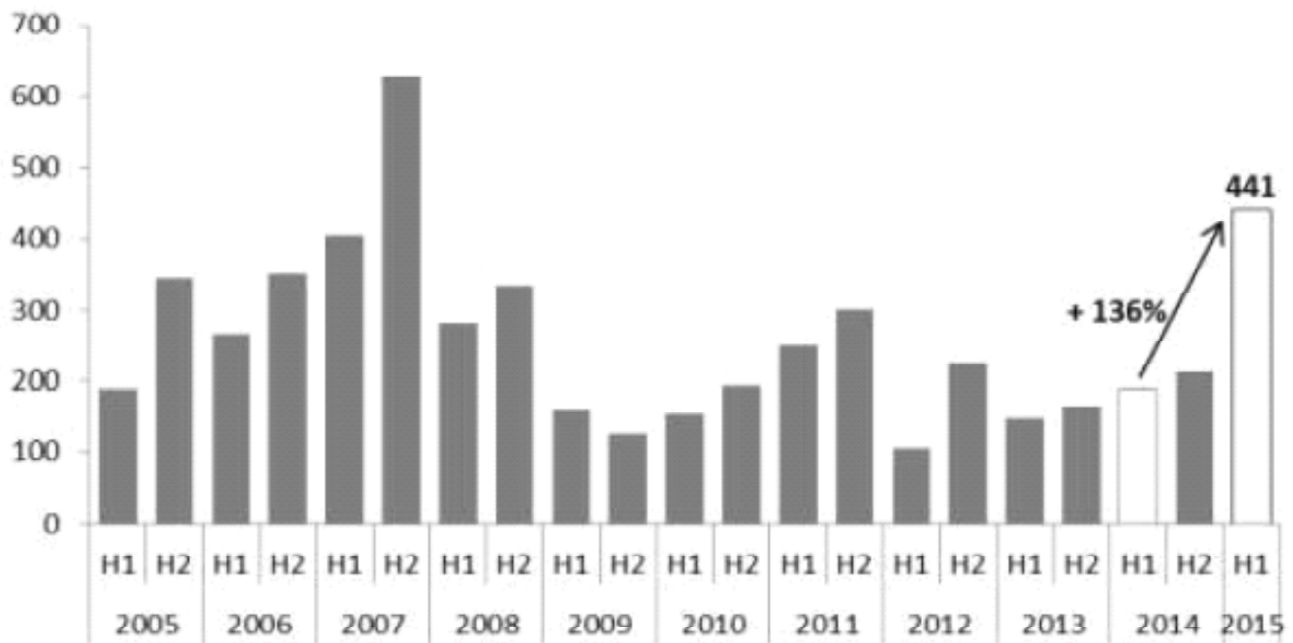
INTRODUCTION

Cross border Mergers and Acquisitions (M&A) are gaining increasing attention in the advent of intense globalization of the world economy. The 1990s were a “golden decade” for these deals with an approximate 200% jump in the volume of cross border mergers in the Asia Pacific. This much needed surge was an outcome of the countries in the region opening up their economies and liberalizing their regulations. Initially, majority of the deals involved acquisitions by developed market firms into emerging markets. This

was followed by a period of intense buying activity originating from emerging markets into developed markets. Recent years have exhibited a growing number of deals where both acquirers and targets are from emerging markets.

A few developing emerging economies in the region, like China, India, Brazil and Russia have attracted the giant share of M&A deals. In recent years, countries like Latin America and Africa have also attracted more deals with their rapid establishment as investment havens. This raises an inevitable question: Is there a propensity for certain macroeconomic factors in the acquirer-target pair that encourages M&A flows?

Year 2015 has been different with respect to the patterns identified in the past. The global cross border mergers and acquisitions (M&As) transactions showed a sharp increase in the first half of 2015. It showed an increase of 136% over the same period in 2014 (Figure 1). The year saw increased participation from multinational enterprises (MNEs) based in developed economies in doing cross border deals. Firms from United States of America (USA) continued to grow strongly (upto more than 100%), however, there was a decline in the cross border M&A activity from the developing nations. European region made a comeback in terms of the net value of purchases and Canadian firms hit their highest half year level on record.



Source: © UNCTAD, cross-border M&A database (www.unctad.org/fdistatistics),

Abbreviation: H1=first half of the year

Figure 1: Value of Cross Border Acquisitions, 2005H1-2015H1 (Billions of US dollars)

The cross border M&A activity raises some very important questions like why have deals from united states been rising, what has led to the decline in the cross border deals for developing economies? what made European region's increased M&A activity. Giovanni (2005) (1) provided an empirical analysis explaining the importance of macroeconomic, financial and institutional variables in explaining the deal flows from

one country to another using a gravity model framework. This study attempts to put together the model for the cross border deals for the year 2015 and highlights the impact of the different country-specific attributes on the deal flows. The objective of the study is to understand the factors which lead to investment flows from one country to another for the year 2015.

REVIEW OF LITERATURE

There are two basic components of foreign direct investments (FDI) – greenfield investments in foreign country or acquisitions. Cross border M&As fall under the second category. Kang & Johansson (2000)(2) observed a six-fold increase in cross border mergers and acquisitions between 1991 and 1998, which constituted more than 80% of global FDI. They observed that cross-border acquisitions were fuelled by a combination of factors : availability of capital in countries such as the U.S. that were going through a period of prolonged economic growth; heightened level of competition due to excess capacity and falling demand in mature industries; desire to seek new markets and resources by high tech firms; search for intangible assets in the form of technology, human resources and brand names; and made possible by liberalization of government policies and regulations internationally. An econometric “gravity model” using panel data was used by Giovanni, J (2005) to identify macroeconomic factors that contribute to cross border acquisitions and flow of capital between various countries. The study was conducted on cross border acquisitions during the period 1990 to 1999. The primary hypothesis in this study was that the size of financial markets, as measured by the stock market capitalization to GDP ratio contributed positively to cross border acquisitions. Other variables in the study were income level, diplomatic relationships between countries, size, distance, information, a common language, exchange rate, tax rates in the target country, tax treaties, trade agreements, goods trade, and wage differentials. Hyun, H., & Kim, H. (2010)(3) researched a large panel dataset covering 101 countries for the period 1989–2005 and found Size of the financial markets of the acquiring company to be a significant factor contributing to cross border acquisitions. Gubbi, Alukh, Ray, Sarkar and Chitoor (2010)(4) used the Economic Freedom Index of the target country as an independent variable to determine the abnormal returns. Ross and Vopin (2004)(5) provided extensive empirical evidence focusing on the differences in laws and regulations among different countries in the world and how these affected the M&A activity. They found that in cross border deals, acquirers had a richer investor protection environment than target countries.

Table 1 provides a summary of the studies and the variables used in research studies in the past to understand cross border deal flows.

DATA AND METHODOLOGY

Data on all Cross Border deals announced in the year 2015 has been downloaded from the Bloomberg Data Base. Deal values have been accumulated by acquirer – target country pairs. Deals with blank values have been deleted and deals for which country level characteristics are not available have been dropped. The resulting data set consisted of 133 acquirer target country pairs. The highest ranking acquirer-target pairs in terms of number of deals and deal value are listed in Table 2. The acquirer- target pair of Canada and USA dominate the cross border acquisition space with 140 deals and a total announced deal value of USD 85,629 million during 2015.

Table 1
Review of Studies on Cross Border Deals (Country Characteristics)

<i>Authors</i>	<i>Variables used in the model</i>	<i>Findings</i>
Vasconcellos and Kish, 1998(6)	Bond yields, exchange rates, and stock prices	The results suggested that foreign acquisitions occur more frequently when bond yields in the acquirer's country are higher than those from the country of the firm being acquired. In addition, a depressed US stock market relative to foreign stock markets encourages foreign acquisition of US companies.
Dunning, 1998(7)	Location	Implications for location of FDI and MNE activities
Markusen <i>et al.</i> , 1996(8)	Knowledge capital	Horizontal and vertical integration in presence of trade costs
Gordon and Bovenberg, 1996(9); Portes and Rey, 1999(10) Hines, 1997(11)	Asymmetric information, information costs Taxation	Model with asymmetric information Impact of different taxation regimes on US FDI
Cushman, 1985(12); Blonigen, 1997(13)	Foreign Exchange	US dollar depreciation encouraged inflow of foreign investment
Kang & Johansson, 2000	Availability of capital level of competition technology, human resources and brand names liberalization of government policies	Main driver for M&A was need to acquire complementary intangible assets
Xu and Shenkar, 2002(14), Kostova and Zaheer, 1999(15)	Institutional distance	Institutional distances and their impact on MNE behaviour
Rossi and Volpin, 2004	Accounting standards, shareholder protection Size of Acquirer and Target	Targets identified to be from nations with poorer shareholder protection
Giovanni, J (2005)	Stock market size Amount of credit provided	Financial Variables and institutional factors significantly affect M&A activity
Daude and Fratzscher, 2007(16)	Information friction variables, market development and quality of economic and political institutions	Pecking order of cross border investments
Morosini, Shane & Singh, 1998(17)	National cultural distance	Positive relationship between national culture distance and cross border acquisition performance
Hyun, H., & Kim, H. (2010)	Size, credit, OECD affiliation, stock market capitalization, exchange rate, common language, distance, law and order, regional trade agreement	Legal and institutional quality and financial development increase M&A volume

Table 2

This table displays the list of acquirer target pairs with the highest number of deals and the highest value of deals in our deal sample during 2015. Deals without disclosed deal values have been deleted from the data set.

<i>Highest Ranking Acquirer- Target Pair by number of deals</i>		<i>Highest Ranking Acquirer- Target Pair by Deal Values</i>	
<i>Acquirer - Target Pairs</i>	<i>Number of Deals</i>	<i>Acquirer - Target Pairs</i>	<i>Total Deal Value (Million USD)</i>
Canada - USA	140	Canada - USA	85,629.09
Hong Kong - China	59	Singapore - USA	46,388.85
China - USA	39	Israel - USA	43,105.71
Japan - USA	38	Japan - USA	35,701.25
Australia - USA	38	Hong Kong - China	13,913.29
Singapore - Australia	34	USA - Australia	12,123.86
USA - Australia	32	Ireland - USA	11,824.31
Germany - USA	19	China - USA	11,282.46
Singapore - Malaysia	16	Australia - USA	9,370.32
Singapore - China	14	Ireland - Switzerland	7,337.20
Singapore - USA	14	Japan - Australia	7,015.63
China - Singapore	14	Spain - USA	5,548.06
Israel - USA	14	China - Australia	5,451.85
India - USA	13	China - Switzerland	4,019.37
USA - Brazil	12	China - Brazil	3,951.60
China - Australia	12	USA - Poland	3,679.18
Malaysia - Singapore	8	USA - Switzerland	3,596.67
USA - China	8	Germany - USA	3,413.63

Deal data has been combined with data required to run the gravity model for cross border merger and acquisition flows. The gravity model, while originally used for explaining the determinants of trade flows, has been applied in a number of research papers to examine cross border mergers and acquisition flows(3,18). Various factors have been identified that could potentially impact cross border merger and acquisition activities. These include the gross domestic product (GDP) of the acquirer and target, market capitalization as a % of GDP of acquirer and target countries, real exchange rate, a measure of law and order in the country of the target, a binary variable that indicates whether there is a common official or national language spoken by at least 20 % of the acquirer and target countries and various measures of cultural distance. The variables used in the study are listed in Appendix 1. Lagged variables from one year prior to the deal announcement have been used in the study. This follows from literature and is based on the idea that firms make acquisition decision based on the previous year's financials.

The model used is

$$\begin{aligned}
 \log MA_{AT} = & \beta + \beta_1 GDP_A + \beta_2 GDP_T + \beta_3 GR_T + \beta_4 SM_A + \beta_5 SM_T + \beta_6 CR_T + \beta_7 ER_T \\
 & + \beta_8 LO + \beta_9 LANG_T + \beta_{10} CONT + \beta_{11} DIST + \beta_{12} PDI + \beta_{13} IDV + \beta_{14} MAS \\
 & + \beta_{15} UAI + \beta_{16} LTOW + \beta_{17} IVR
 \end{aligned} \tag{1}$$

$\log MA_{AT}$	Natural log of Total Deal value between the acquirer target pair
Ln_GDP_A	Natural log of GDP of Acquirer (19)
Ln_GDP_T	Natural log of GDP of Target (19)
GR_T	Growth of GDP of target(19)
SM_A	Stockmarket capitalization of acquirer as a % of GDP(19)
SM_T	Stockmarket capitalization of target(19)
CR_T	Credit of target country as a % of GDP (19)
ER_T	Exchange rate of target (19)
LO	Law and order (20)
LANG	Common Language (21)
CONT	Contiguity (21)
DIST	Distance from CEPII(21)
PDI	Hofstede measure of powerdistance(22)
IDV	Hofstede measure of Individualism vs collectivism(22)
MAS	Hofstede measure of Masculinity vs Femininity(22)
UAI	Hofstede measure of Uncertainty avoidance index (22)
LTOW	Hofstede measure of Long term vs Short term Orientation(22)
IVR	Hofstede measure of Indulgence vs restraint (22)

Table 3 provides the results for correlation between the variables in the study. There is a high correlation between the exchange rate of the target and growth rate of GDP of the target, stock market capitalization of the target and the credit of the target country as a percentage of the GDP. The correlation between the credit of the target firm and stock market capitalization of the target is also high at 0.76. The other variable pairs that display a high correlation are the law and order index in the target firm with the Credit to GDP ratio of the target; the individualism index and exchange rate of target firms, individualism and power distance of the target, indulgence and long term orientation; GDP of the target and stock market capitalization of the target. Considering the correlation between the explanatory variables, the following regression equations have been identified.

$$\log MA_{AT} = \beta + \beta_1 GDP_A + \beta_2 GDP_T + \beta_3 SM_A + \beta_4 SM_T \quad (2)$$

$$\log MA_{AT} = \beta + \beta_1 GDP_A + \beta_2 GDP_T + \beta_8 LO + \beta_4 LANG_T + \beta_5 CONT + \beta_6 DIST \quad (3)$$

$$\log MA_{AT} = \beta + \beta_1 GDP_A + \beta_2 GDP_T + \beta_3 PDI + \beta_4 MAS + \beta_5 UAI + \beta_6 LTOW \quad (4)$$

$$\log MA_{ij} = \beta + \beta_1 GDP_A + \beta_2 GDP_T + \beta_3 SM_A + \beta_4 SM_T + \beta_5 LO + \beta_6 LANG_T + \beta_7 CONT + \beta_8 DIST + \beta_9 PDI + \beta_{10} MAS + \beta_{11} UAI + \beta_{12} LTOW \quad (5)$$

RESULTS

Table 4 provides the results of the regression tests using log of the total deal value between acquirer and targets pairs as the dependent variable and macroeconomic, financial, institutional and cultural factors as independent variables. Model 1 estimates a model using the GDP of acquirer, GDP of the Target and

Stock Market Capitalization of Acquirer and Target firms as independent Variables. The results indicate that the deal value between acquirer target pairs is positively impacted by the GDP of the acquirer and target and also the stock market capitalization of the acquirer. Hence, the size of the GDP of acquirer and target nations positively impacts the deal values. This is supported by the fact that firm from Canada and USA which rank high in terms of world GDP rankings are the highest ranking acquirer target pairs. Model 1 also shows that stock market capitalization of acquirers positively impact the deal value. Firms with well developed markets with higher stock market capitalization are more likely to be the acquirers. Table 3

Table 3

Displays the correlation between the variables in the study. Variables with a correlation above 0.50 are in bold

	GR _T	SM _A	SM _T	CR _T	ER _T	LO	LANG	CONTG	DIST	PDI	IDV	MAS	UAI	LTOW	IVR	ln_ GDP _A	ln_ GDP _T
GR _T	1.00																
SM _A	0.05	1.00															
SM _T	0.40	-0.02	1.00														
CR _T	0.18	-0.02	0.76	1.00													
ER _T	0.66	0.04	0.81	0.63	1.00												
LO	0.21	0.03	0.28	0.71	0.38	1.00											
LANG	0.16	0.17	0.04	0.19	0.20	0.26	1.00										
CONT	0.01	0.04	0.05	-0.04	0.00	-0.11	0.09	1.00									
DIST	-0.15	-0.03	-0.04	0.08	-0.14	0.03	-0.03	-0.38	1.00								
PDI	0.21	0.11	-0.29	-0.59	-0.15	-0.65	-0.07	0.11	-0.18	1.00							
IDV	-0.11	-0.08	0.22	0.51	0.08	0.62	0.04	-0.13	0.21	-0.85	1.00						
MAS	0.39	-0.06	0.33	0.11	0.36	0.07	-0.08	0.00	-0.06	-0.36	0.41	1.00					
UAI	-0.43	-0.14	-0.51	-0.59	-0.64	-0.38	-0.39	0.01	0.02	-0.02	0.07	-0.05	1.00				
LTOW	0.02	0.11	0.32	0.08	0.36	-0.06	-0.09	0.10	-0.28	0.26	-0.47	0.00	-0.27	1.00			
IVR	-0.23	-0.14	-0.16	0.20	-0.24	0.04	0.07	-0.06	0.29	-0.43	0.34	0.05	0.09	-0.63	1.00		
ln_GDP _A	-0.02	0.33	-0.08	-0.07	-0.05	-0.06	-0.18	0.03	0.13	0.11	-0.16	-0.07	-0.03	0.13	-0.04	1.00	
ln_GDP _T	0.00	-0.08	0.78	0.60	0.39	0.10	-0.05	0.03	0.14	-0.37	0.45	0.19	-0.19	-0.11	0.11	-0.15	1.00

Model 2 adds variables on Law and order index, geographical distance, common language and land locked country dummy variables. The results of Model 2 show that having a common language positively influences cross border acquisitions between acquirer and target pairs. Law and order in the target, distance and contiguity does not influence the deal value. Firms having a common language are more likely to get into a cross border merger or acquisition deal. The results pertaining to no influence of law and order index should be interpreted cautiously and may require to be collaborated with additional data in future research.

Model 3 uses variables from Hofstede cultural index. The Hofstede variables used are power distance, masculinity v/s femininity and a measure of uncertainty avoidance index. Results of Model 3 indicate that the deal value is negatively influenced by the power distance between acquirer target pairs and the masculinity v/s femininity measure index. This finding highlights the fact that more the power distance between acquirer

Table 4

This Table displays the results of regression with the log of total deal value between acquirer target pairs as the dependent variable. Model 1 uses the GDP of acquirer, GDP of the Target and Stock Market Capitalization of Acquirer and Target firms as independent Variables. Model 2 adds variables on Law and order index, geographical distance, common language and land locked country dummy variables. Model 3 uses variables from Hofstede cultural index and Model 4 adds all the explanatory variables in the earlier models. Model 5 uses the ratio of GDP of Acquirer to target as an explanatory variable. The superscripts ***, **, and * denote significance at the 1%, 5%, and 10% levels respectively. Standard errors are in parenthesis

Variables	Model 1	Model 2	Model 3	Model 4	Model 5
ln_GDP _A	0.291** (0.142)	0.524*** (0.142)	0.463*** (0.136)	0.430*** (0.145)	
ln_GDP _T	1.007*** (0.211)	0.737*** (0.137)	0.601*** (0.145)	0.754** (0.332)	
GDP_Ratio _{AT}					0.0256* -0.0153
SM _A	0.005*** (0.001)			0.005*** (0.001)	
SM _T	-0.005 (0.003)			-0.001 (0.005)	
LO _T		1.667 (1.028)		0.466 (1.687)	(2.276) -1.747
LANG		1.210** (0.474)		1.189** (0.508)	0.666 -0.543
CONTG		-0.244 (0.785)		-0.35 (0.735)	0.424 -0.832
DIST		0.000 (0.000)		0.000 (0.000)	(0.000) -5.47E-05
PDI			-0.034*** (0.011)	-0.029* (0.016)	-0.0629*** -0.0168
MAS			-0.045** (0.019)	-0.037* (0.022)	-0.0495** -0.0223
UAI			0.001 (0.009)	0.017 (0.013)	(0.011) -0.0122
LTOWS			-0.008 (0.010)	-0.006 (0.013)	(0.007) -0.0109
Constant	-13.140*** (3.613)	-13.870*** (3.021)	-4.651 (3.546)	-8.809 (7.234)	14.35*** -3.482
Observations	133	133	133	133	133
R-squared	0.281	0.274	0.29	0.398	0.182

and target countries, less is the deal value. Hence, firms prefer to deal with firms from countries which have a similar cultural orientation with respect to power and authority and avoid dealing with firms from countries which contrast with them with on this aspect. Also, if the acquirer and target countries' societies have similar preferences for achievement, heroism, assertiveness and material rewards for success, then deal value seems to be higher.

Model 4 shows that the results pertaining to common language, GDP or acquirer and target firms, stock market capitalization, power distance and masculinity v/s feminityhold when all the explanatory variables are added in the same model. Though the significance level of some of the variables is reduced.

Model 5 uses the GDP ratio of acquirer to target firms as an explanatory variable. The results suggest that there is a positive relationship between acquiring firms GDP to target firm GDP and the deal value. This result seems to be in line with the reasoning that firms from countries with larger GDP are acquirers and firms from countries with smaller GDP are typically the targets in a cross border merger and acquisition deal.

Implications of the Study for Indian Economy

Table 5 displays the acquisition pairs where Indian firms are the acquirers. Indian firms have made the largest number of acquisitions in USA followed by Australia and Switzerland in 2015. It appears that Indian firms have shown a propensity to acquire firms in Developed countries with higher GDPs, better law and order scores, larger stock market capitalization than India and firms with a large power distance from India. This seems to indicate that Indian firms have not followed the general results found for the population of firms. With Indian institutional and regulatory environment poised for changes and reforms such as the make in India initiative, Indian firms are likely to look for acquiring resource capabilities internationally with cross border acquisitions being a primary driver.

Table 5
This Table provides the descriptive data about cross border acquisitions made by Indian firms

<i>Acquirer - Target Pairs</i>	<i>Total Deal Value (Million USD)</i>	<i>Number of Deals</i>	\ln_{GDP_A}	\ln_{GDP_T}	SM_A	SM_T	<i>LANG</i>	<i>CONTG</i>	<i>PDI</i>	<i>MAS</i>	LO_T
India-USA	2,410.29	13	14.53	16.67	37.23	230.67	1	0	40	62	0.83
India - Switzerland	480.43	2	14.53	13.46	37.23	143.70	0	0	34	70	0.83
India -Australia	349.15	3	14.53	14.19	37.23	56.04	1	0	38	61	0.92
India - Singapore	20.54	2	14.53	12.64	37.23	67.65	1	0	74	48	0.83
India - China	0.02	1	14.53	16.15	37.23	361.90	0	1	80	66	0.58

Several factors could contribute towards Indian firms building or acquiring capabilities. In terms of research and development, Indian firms could acquire firms internationally which could provide expertise in this field and help local firms to manufacture products in India. Also, regulatory environments and financial depth in other countries could help local firms expand with ease. Policy makers could encourage this capability seeking behaviour of Indian firms and lead to more growth in FDI through cross border mergers and acquisitions.

CONCLUSION

The objective of this study was to determine the drivers of capital flows in the form of cross border acquisitions using a form of gravity model. Results show that the GDP of the acquiring country and stock market capitalization of the acquiring firm is significantly higher. Language is an important driver of international acquisitions, as having a common language has a positive impact on deal value. Hofstede's power distance indicators and masculinity v/s femininity scores negatively influence the deal value. If Acquirer and target firms have significantly similar hierarchical structures and levels of assertion then deal values tend to be higher.

An analysis of deals done by India firms shows that Indian firms seem to target firms with higher GDP and better law and order situation. This indicates that Indian firms are looking for better resource capabilities and cross border mergers and acquisitions might help them build these capabilities.

The study has used acquisitions in the year 2015 for analysis. A larger data set may produce different results. Further work in the area could entail using a panel data for several number of years especially for emerging economies like India. A more detailed analysis could be helpful in understanding the differences/similarities between emerging economy deals and developed economy deals.

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Appendix 1

<i>Abbreviation</i>		<i>Denomination</i>
GDP _A	Lagged GDP of Acquirer	Millions of U.S Dollars
GDP _T	Lagged GDP of Target	Millions of U.S. Dollars
GR _T	Growth of GDP of target	GDP growth (annual %)
SM _A	Lagged tockmarket capitalization of Acquirer as a % of GDP	Stocks traded, total value (% of GDP)
SM _T	Lagged Stockmarket capitalization of target	Stocks traded, total value (% of GDP)
CR _(T)	Lagged Credit of target country	domestic credit as % of GDP
ER _(T)	Lagged Exchange rate of target	Real effective exchange rate index (2010 = 100)
LO	Lagged Law and order	Values from 0-6
LANG	Common Language	Official or national languages spoken by atleast 20% of the population (Binary)
CONT	Contiguity	Landlocked countries- dummy variables(Binary)
DIST	Distance	Internal distance between countries
PDI	Powerdistance	Index
IDV	Individulaism vs collectivism	Index
MAS	Masculinity vs Feminity	Index
UAI	Uncertainty avoidance index	Index
LTOW	Long term vs Short term Orientation	Index
IVR	Indulgence vs restraint	Index