

FIRM GOVERNANCE AND SHAREHOLDER VALUE CREATION:
A STUDY OF CROSS-BORDER ACQUISITIONS
BY U.S. ACQUIRING FIRMS

By

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ABSTRACT

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Cross-border acquisitions have become an important part of the arsenal of strategies that firms deploy in internationalizing their operations. With the significant resources that are generally involved in such transactions and the wide range of performance outcomes, it is important that research examine the factors that contribute to the performance of such acquisitions. My study seeks to do that. By drawing primarily on agency theory, I examine the role of firm governance in the creation of value from the perspective of shareholders at U.S. acquiring firms in international acquisitions. Further, guided by the tenets of transaction cost economics and resource dependency theory, I examine whether the relationships between different firm governance mechanisms and shareholder value creation are contingent on key environmental and firm factors.

Study findings indicate that the presence of certain governance mechanisms facilitate the realization of shareholder value from the standpoint of bidding firms. Specifically, firms with larger boards, longer outside director tenure, and greater inside and outside director ownership

were associated with superior acquisition performance. However, contrary to agency theory predictions, my results indicate that CEO influence has a positive impact on bidder returns. In addition, my findings indicate that the relationship between firm governance and shareholder value creation is contingent on certain contextual factors. For example, bidding firms with limited cross-border acquisition experience benefit from the presence of outside directors with longer tenures in the creation of shareholder value.

My study has important implications for both the theory and managerial practice. From a theoretical perspective, its contribution lies in the development of arguments linking firm governance structures and shareholder returns in cross-border acquisitions. From an empirical perspective, my study employs the BHAR methodology in the assessment long-term wealth effects and, thereby, emphasizes the usefulness of this methodology in the examination of value creation related to other key strategic decisions. In addition, my study highlights the importance of using multiple theoretical perspectives in the study of a complex phenomenon such as cross-border acquisitions. While agency theory remains the dominant theory in the study of the effects of corporate governance, my findings suggest that it needs to be complemented by other theoretical perspectives such as stewardship and resource dependency theories. Finally, from a managerial standpoint, I expect my findings to provide guidance to firms interested in cross-border acquisitions. While transactional attributes are undoubtedly important, my findings indicate that it is also important to consider managerial interests and the role of governance structures in ensuring that value is maximized in such transactions.

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CHAPTER 1

INTRODUCTION

According to UNCTAD (United Nations Conference for Trade and Development) records, there were 108 international mega-mergers (worth at least \$1 billion) totaling \$352.5 billion in 2009 alone. Of the top 6 valued in excess of \$10 billion, half involved a U.S. or a U.K. firm as a purchaser or seller. While cross-border acquisitions have been viewed as primarily being an Anglo-Saxon phenomenon, with the U.S. and U.K accounting for roughly 30%¹ of global cross-border acquisition value² over the past 20 years, the landscape has changed dramatically in recent years. For example, while firms from developing countries accounted for barely 7% of the total value of cross-border deals in 1990, they now represent nearly 30% of the global acquisition transaction value. Together, three countries, namely, China, India, and Mexico, today account for nearly a third of this value. However, U.S. firms are still very active in the arena of cross-border acquisitions. As Figure 1.1 illustrates, at its peak in 2007, the total value of acquisitions by U.S. firms was nearly \$180 billion, representing around 18% of the total global value of such transactions.

This increase in the cross-border acquisition activity can be largely attributed to the rapid globalization that we have witnessed over the past couple of decades. Challenges posed by globalization have increasingly forced U.S. firms to expand into foreign markets and become viable players in the global marketplace. And, while a number of options are available for foreign market entry, firms have often relied on cross-border acquisitions for rapid internationalization. According to information provided in the Thompson Financial SDC

¹ Figures based on the number of cross-border transactions were similar.

² Based on UNCTAD figures from 1990-2009. Cross-border acquisition purchases calculated on a net basis- purchases of companies broad by home-based TNCs less sales of foreign affiliates of home-based TNCs.

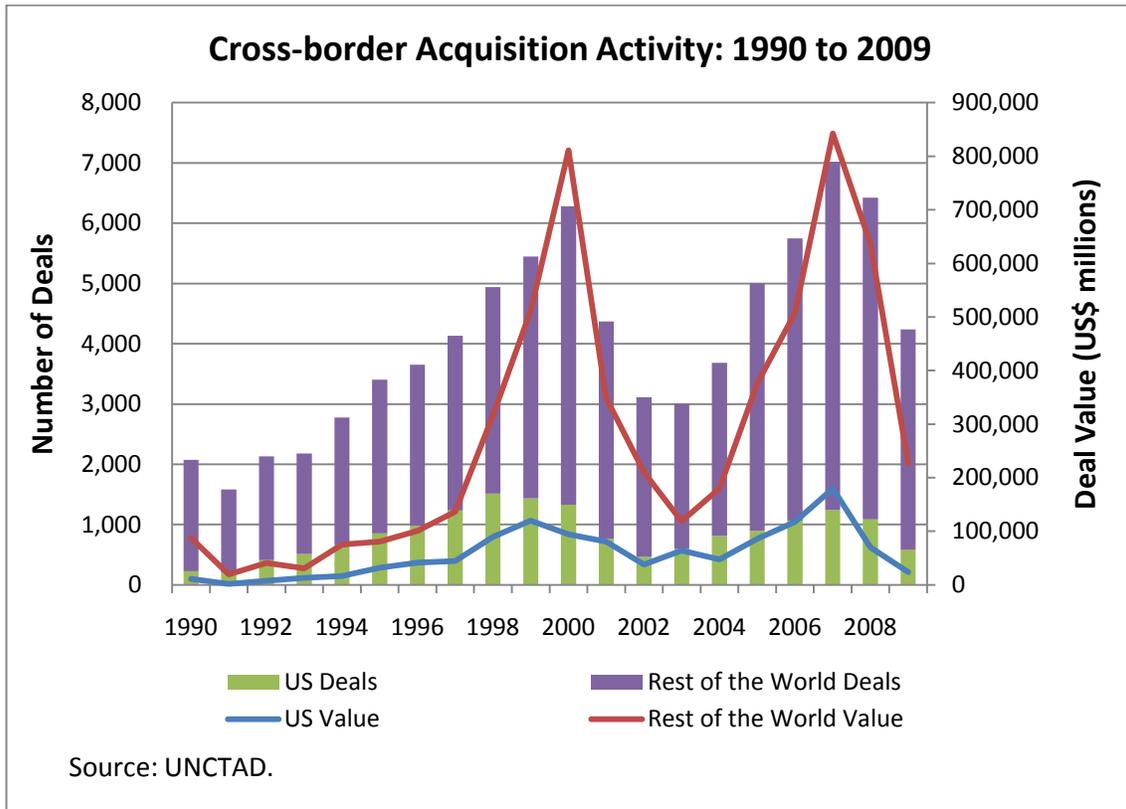
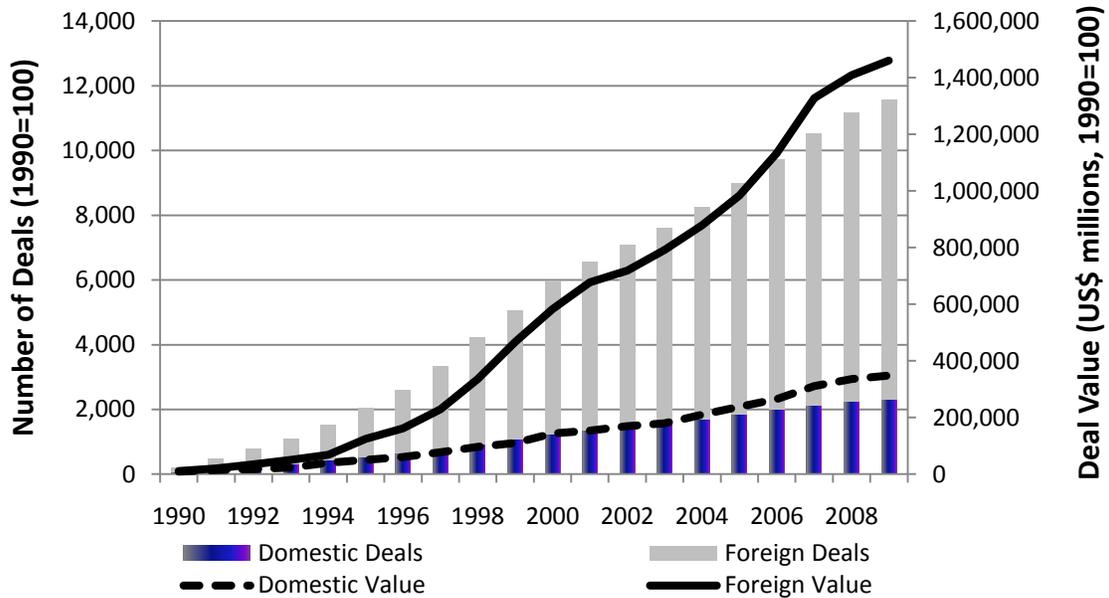


Figure 1.1 Global and U.S. Cross-Border Acquisition Activity from 1990 to 2009

database, information provided in the Thompson Financial SDC database, increases in international acquisitions activity among U.S. firms has even surpassed that in the domestic arena. This dramatic increase is depicted in Figure 1.2, wherein I graph the cumulative completed acquisition activity by U.S. firms using 1990 as the base year (both in terms of the number of deals and total deal value). The total number of completed domestic acquisitions ranged from 60 to 161 transactions with a cumulative value of between \$3 and \$45 billion while foreign acquisitions numbered between 134 and 741 transactions with an aggregate value ranging from \$8 to \$193 billion. Many of them are in the services sector. In fact, one of the largest cross-border deals in recent years involves two firms in the global financial services industry – with BlackRock acquiring Barclay PLC’s investment unit Barclays Global Investors for \$13.3 billion in 2009. With this acquisition, BlackRock aimed to increase

Cumulative Acquisition Activity by U.S. firms: 1990-2009



Source: Thompson Financial SDC.

Figure 1.2 Cumulative U.S. Acquisition Activities from 1990 to 2009 with 1990 as the Base Year

its power in the market place by bringing "... products together that no one else could offer," according to its CEO, Laurence D. Fink (New York Times, June 12, 2009).

Unfortunately, cross-border acquisitions have also been characterized by a high failure rate with a high percentage of transactions destroying shareholder value. KPMG's (1999) report involving a total of 700 global mergers and acquisitions undertaken between 1996 and 1998 highlights this problem. Only 17% of the transactions in their study resulted in improved shareholder value while 53% lost value. In 30% of the cases, there were no discernible differences. Examples of failed acquisition include the acquisition of Volvo by Ford in 1999 for \$6 billion. A decade later, Ford ended up selling its Volvo subsidiary to the Chinese car manufacturer Geely for \$1.8 billion. Likewise, in 2007 Daimler Benz sold Chrysler to the private equity firm Cerberus for a \$7.4 billion after paying nearly \$37 billion for it in 1998. On the other hand, some cross-border acquisitions have turned out to be successful for

Table 1.1 Acquisition Activity by U.S. Firms from 1990 to 2009

Year	Domestic Acquisitions		Foreign Acquisitions	
	DEALS (in number)	VALUE (in US\$ millions)	DEALS (in number)	VALUE (in US\$ millions)
1990	82	9,136.97	134	11,589.04
1991	66	5,353.96	194	8,748.05
1992	77	3,375.39	225	15,005.55
1993	83	6,233.11	231	14,940.43
1994	113	16,309.97	313	18,422.68
1995	113	10,551.05	410	55,635.04
1996	112	9,343.02	456	37,148.00
1997	141	17,710.47	595	67,609.09
1998	144	18,886.37	752	106,831.31
1999	135	12,907.43	682	131,002.30
2000	161	33,525.28	741	116,094.05
2001	124	10,368.67	488	94,881.17
2002	112	16,189.87	394	40,931.17
2003	112	10,347.75	411	73,381.33
2004	127	29,450.34	537	86,160.04
2005	143	28,693.81	578	105,884.15
2006	150	27,127.52	588	149,602.84
2007	139	45,606.37	671	193,941.70
2008	108	24,355.21	518	81,325.76
2009	60	13,156.46	338	52,012.13

the acquiring firm. An interesting example is Adidas-Salomon AG's \$3.7 billion acquisition of Reebok in 2005. At the time of the acquisition, Adidas had an \$8.9 billion market value. After two years, and no other major acquisitions, Adidas almost doubled its market value to \$15.2 billion.

With cross-border acquisitions increasing in importance, the vast amount of resources committed to their undertaking and the associated high failure rates, it is not surprising that the study of cross-border acquisition performance has assumed considerable importance. Several studies having been conducted towards understanding what determines value creation in such transactions. Much of this research has examined performance implications by examining shareholder wealth effects associated with cross-border acquisitions at the time of announcement. In addition, scholars have sought to study the effects of acquisition type (e.g., Datta & Puia, 1995; Francis, Hasan, & Sun, 2008; Markides & Ittner, 1994), host country

characteristics (e.g., Doukas & Travlos, 1988; Gleason, Mathur, & Wiggins III, 2006), cultural differences (e.g., Chakrabarti, Gupta-Mukherjee, & Jayaraman, 2009; Datta & Puia, 1995) and the nature of an acquiring firm's intangible assets (e.g., Markides & Oyon, 1998; Morck & Yeung, 1992) on such performance. However, several important issues related to the effects of firm characteristics have remained unexplored.

At the same time, a significant body of research has emerged on the relationships between firm governance structures and firm strategic choices along with an examination of the performance implications of such choices (see meta-analytic reviews by Dalton, Daily, Certo, & Roengpitya, 2003; Dalton, Daily, Ellstrand, & Johnson, 1998; and, Dalton, Daily, Johnson, & Ellstrand, 1999 on board composition and size, duality, and ownership). Much of this research has been built around agency theory with scholars studying the influence of governance structures on firm strategy in both the domestic (e.g., Amihud & Lev, 1981; Bethel & Liebeskind, 1993; Masulis, Wang, & Xie, 2007) and international context (e.g., Datta, Musteen, & Herrmann, 2009; Musteen, Datta, & Herrmann, 2009; Sanders & Carpenter, 1998). In addition, the extensive literature on corporate governance in the finance and strategic management literatures has explored the relationships between different governance mechanisms and firm performance in the context of firm strategies such as diversification (e.g., Amihud & Lev, 1981; Denis, Denis, & Sarin, 1997; Lane, Cannella, & Lubatkin, 1998), divestitures (e.g., Bergh, 1995), firm internationalization (e.g., Mishra & Gobeli, 1998) and strategic alliances (e.g., Reuer & Miller, 1997). Built primarily around agency theory arguments (Fama & Jensen, 1983b; Jensen & Meckling, 1976), corporate governance research relates to the design of governance structures that mitigate "agency problems" -- the propensity on the part of agents (firm managers) to pursue strategies that are driven by their own goals and interests rather than those of shareholders. To minimize agency problems, principals (owners) resort to governance mechanisms towards aligning the interests of managers with their own. Two approaches have been adopted. The first relates to enhanced oversight and monitoring of firm management, the

strategic decisions they make and their implementation (Baysinger & Butler, 1985). The second approach involved the use of incentive mechanisms in the form of equity ownership that results in managers and directors, as significant equity owners, viewing issues from the perspective of shareholders.

While recent studies by Datta, Musteen and Herrmann (2009) and Musteen, Datta and Herrmann (2009) have examined the effects of governance mechanisms in the context of entry mode choice (including, the choice between cross-border acquisitions and joint ventures), there has been minimal research on how governance structures influence the performance of cross-border acquisitions. As argued by Ben-Amar and Andre (2006), agency problems arising out of weak governance structures are likely to have an important deleterious impact on the performance of acquisitions. Without adequate governance mechanisms in place, opportunistic managers can use acquisitions to extract private gains at the expense of firm shareholders. Such gains can take the form of reduced employment risk arising from diversification, empire building that result in increased power and higher compensation from increased firm size. It can be argued that effective governance structures characterized by appropriate levels of monitoring and incentive mechanisms that align the interests of managers and shareholders can mitigate agency problems in the context of cross-border acquisitions.

The objective of this dissertation study is to improve our understanding of the role of firm governance in influencing long-term value creation in cross-border acquisitions. Specifically, this study addresses the following broad questions:

1. Are cross-border acquisitions associated with long-term value creation from the standpoint of bidding firm shareholders?
2. How do governance mechanisms influence the extent of shareholder value from the standpoint of acquiring firms?
3. Are the relationship between governance structures and value creation contingent on key environmental and firm factors?

Prior empirical research has predominantly used the event study methodology to examine wealth effects associated with cross-border acquisitions. This has been done over relatively short windows surrounding the announcement date with the wealth effects essentially measuring market expectations at the time of announcement. The findings have been equivocal. It might be a reflection of the fact that short-term announcement effects, despite the increasing amount of information that is available to market participants, may not represent an accurate predictor of actual long-term value creation (Conn, Cosh, Guest, & Hughes, 2005). As Datta, Pinches and Narayanan (1992) have argued, the market's reaction to the announcement of an acquisition does not necessarily take into account the information that managers often uniquely possess on the true merits of the acquisition. One way to overcome this problem (in assessing the true effects of cross-border acquisitions) is to examine the returns over a longer time frame that allows the incorporation of additional information related to the acquisition that might be revealed following its completion. With recent advances made in the assessment of long-term market returns, such as the buy-and-hold abnormal returns (BHARs) methodology (Lyon, Barber, & Tsai, 1999) used in this study, an accurate measure of cross-border acquisition performance in the long-run is now possible.

I expect this study to make several important contributions to research and managerial practice related to cross-border mergers and acquisitions. First, and foremost, it seeks to address an important gap in the literature on cross-border acquisitions on whether board characteristics and ownership structures impact the extent of shareholder value that is created in such acquisitions. From a theoretical perspective, this study provides a different perspective from that in extant research – one that has been dominated by an examination of the effects of transactional attributes (e.g., relatedness, method of payment, and presence multiple bidders) and environmental factors (e.g., cultural distance, political risk, and country size/growth). My research also represents a departure from the implicit assumption that characterizes much of the existing research on cross-border acquisitions, namely, that the choice of such acquisitions

is dictated purely by economic considerations. Studying the effects of governance mechanisms, based largely on agency theory arguments, allows me to examine how managerial objectives and interests influence value creation in such transactions. In addition, I examine whether the monitoring of firm management by outside directors and institutional owners and the use of incentives in the form of equity ownership contribute to enhanced returns in such acquisitions. From a practitioner standpoint, the findings should inform managers and shareholders whether and how alternative governance structures impact acquisition success. Hopefully, my findings will prompt firms to carefully examine the appropriateness of their governance structures prior to engaging in cross-border acquisitions to ensure that they facilitate value creation in such transactions.

The rest of the dissertation is structured as follows. In the next chapter, I review the literature on value creation in cross-border mergers and acquisitions and discuss the factors that have been hypothesized to impact such value creation. In addition, the literature on the role of corporate governance in the context of acquisitions and internationalization is also reviewed. Chapter 3 details the research model adopted for this study and presents the study hypotheses related to the effects of governance mechanisms on long-term shareholder value creation from the standpoint of acquiring firms in cross-border acquisitions. Chapter 4 describes the sample, the study variables and their operationalization, and also the methodology employed in the assessment of long-term wealth effects. The findings are presented in Chapter 5. Chapter 6 discusses the results, the contributions of this study, its limitations, and also provides possible directions for future research.

CHAPTER 2

LITERATURE REVIEW

In the following sections, I review the literature on the performance effects of cross-border acquisitions. In addition to an overview of the theoretical literature that relates to the value creating potential of such acquisitions, I review the empirical research that has examined value creation in the context of cross-border acquisitions.

2.1 Cross-Border Acquisitions: A Review of Theory and Past Research

2.1.1 Value Creation in Cross-Border Acquisitions: Theoretical Overview

Dunning's (1973) "OLI" framework provides a rationale on why cross-border acquisitions ought to create value. This framework suggests that a confluence of factors, representing ownership, location, and internalization, can help explain the value creation potential of foreign acquisitions. First and foremost, from an ownership perspective (the "O" in the OLI framework), tangible and intangible assets owned by a firm (e.g., superior management and marketing skills, patent-protected technologies, product differentiation) when deployed in foreign markets via acquisitions can result in economic benefits. Likewise, value can be created when an acquisition results in a firm being able to leverage the acquired firm's tangible and intangible assets (Eun, Kolodny, & Scheraga, 1996). The "L" represents the advantages of choosing a target in an international location that will allow the firm to reduce its costs or improve its revenues and subsequently improve shareholder value. All else being equal, an acquisition in a country experiencing rapid economic growth or one where the focal industry is characterized by significant entry barriers should have a greater likelihood of success. Finally, from an internalization perspective, when a firm chooses to acquire an existing firm in order to internalize intangible assets it can result in the reduction of transaction costs from market imperfections. Additionally, a firm will internalize operations overseas through an acquisition so

as to expropriate all the rents from the deployment of its intangible assets, both developed internally and acquired from foreign targets, and realize synergistic gains through asset sharing and economies of scale and scope (Seth, 1990).

From a foreign direct investment (FDI) perspective, cross-border acquisitions can be expected to generate superior performance when acquiring firms access new markets and specialized resources (Cooke, 1988). When compared to other FDI modes, cross-border acquisitions enable firms to exploit market opportunities more quickly since the acquired firm already has the support structures (e.g., local network of suppliers and marketing channels) in place (Datta & Puia, 1995). In addition, geographical diversification can provide risk-spreading benefits from uncorrelated financial markets, political climates, and demand conditions (Aybar & Ficici, 2009). However, cross-border acquisitions are less likely to result in enhanced shareholder value in the context of unrelated acquisitions which are devoid of operating synergies (Datta & Puia, 1995). However, when such acquisitions involve firms in related industries, it may increase shareholder value in the long-run (Doukas & Lang, 2003). In such situations, increased returns may be the result of firms' ability to cross-sell their products thereby creating a bigger market base and increased sales.

A cross-border acquisition can also be viewed as an expansion of a firm's multinational network where economic value is created via reduced costs from economies of scale and scope (Datta, 1991; Lee and Lieberman, 2010). In the former, value is created when an acquisition results in the combined entity being able to lower its fixed costs relative to revenues of the company (e.g., via combined purchasing or joint production). Economies of scope, on the other hand, involves enhanced efficiencies from the sharing of tangible and intangible assets resulting in more efficient utilization of assets (e.g., distribution channels, advertising, brand names, R&D facilities and production capabilities). In addition, related acquisitions can benefit from increased market power (Seth, 1990) and to the use of such power to lower cost structures (e.g., being able to set prices or reducing the cost of supplies). Finally, value can result from

acquiring firms being able to leverage knowledge developed across different units (e.g., transfer of marketing knowledge from the acquiring firm to the acquired entity or vice versa), and being able to mitigate the effects of institutional restrictions (Doukas & Travlos, 1988).

2.1.2 Empirical Evidence: Value Creation in Cross-Border Acquisitions

2.1.2.1 Returns over short windows around the announcement date

Studies on acquiring firm returns in international acquisitions have primarily been undertaken in the areas of finance, strategic management and international business. Table 2.1 lists these studies along with a description of the study sample, the variables of interest and the findings. As is evident from the table, most studies have employed the event study methodology with differing estimation periods and different windows over which abnormal returns were estimated.

An examination of the studies indicates that findings related to short term wealth effects (around the announcement date) from the standpoint of bidding firms in cross-border acquisitions are equivocal. A majority of the studies (Amihud, De Long, & Saunders, 2002; Doukas & Travlos, 1988; Moeller & Schlingemann, 2005; Reuer & Miller, 1997; Wooster, 2006) indicate that cross-border acquisitions by U.S. firms do not result in significant gains or losses in shareholder value in the period surrounding the announcement date. However, studies by Markides and Ittner (1994) and Black, Jandik, and Henderson (2007), found positive wealth effects associated with foreign acquisitions by U.S. firms. In contrast, research by Datta and Puia (1995) observed significant negative abnormal gains over most of the event windows that they employed in their study.

Interestingly, among studies that have examined the performance of cross-border acquisitions by non-U.S. firms, a majority (Amihud et al., 2002; Ben-Amar & André, 2006; Cakici, Hessel, & Tandon, 1996; Chakrabarti et al., 2009; Conn et al., 2005; Eun et al., 1996; Francis et al., 2008; Goergen & Renneboog, 2004; Kang, 1993) have found positive short-term shareholder wealth effects. In another study, Doukas (1995) found that foreign acquisitions do

generate positive returns in the 2-day window surrounding the announcement date – however, it was only so in the case of firms characterized by high growth prospects. Interestingly, the study by Wooster (2006) found that while returns over the whole study period (1989-99) were not significant, those associated with acquisitions made between 1989-1992 were positive and significant in the (-1,+1) window. In addition, studies by Cybo-Ottone and Murgia (2000), Gregory and McCorriston (2005) and Seth, Song and Pettit (2002) have found no significant returns associated with international acquisitions and in their recent study, Aybar and Ficici (2009) observed that acquirers from emerging markets experienced significant shareholder wealth losses in the 3-day window surrounding the announcement date.

In sum, research related to the short-term wealth effects of cross-border acquisitions has been growing over the past couple of decades and while most of what we know involves studies in the area of finance, there have been a few studies in the management area (Aybar & Ficici, 2009; Datta & Puia, 1995; Markides & Ittner, 1994; Meschi & Metais, 2006; Seth et al., 2002). Overall, this body of research indicates that, on average, cross-border acquisitions do not result in value creation in the short-term. However, differences across studies in terms of their samples and methodology employed (e.g., different estimation periods and examination windows) makes the comparison of results somewhat challenging.

2.1.2.2 Studies examining long-term shareholder value creation

While relatively few studies have examined long-term returns from cross-border acquisitions, interest in measuring long-term outcomes associated with such transactions has been growing over the past few years. This is particularly true in the area of finance. Of the fourteen studies that have examined long-term effects, only two were published prior to 2000, with 75% appearing in print over the past five years. Only seven involved the computation of buy-and-hold abnormal returns (BHAR) or calendar time abnormal returns (CTAR). A list of all studies on long-term value creation is provided Table 2.2.

Table 2.1 Key Studies on Short-Term Bidder Wealth Effects of Cross-Border Acquisitions

Study	Data	Window	Variables examined	Findings
Doukas & Travlos (1988)	301 acquisitions by 202 U.S. firms from 1975 to 1983	(-10,+10)	Host country development (dummy), prior presence in host country (dummy), relatedness (dummy)	Abnormal returns in the (-10, +10) window were non-significant. Firms entering less developed countries and the target host country for the first time experienced greater shareholder wealth creation
Morck & Yeung (1992)	322 acquisitions by U.S. firms from 1978 to 1988	Day 0	R&D intensity, advertising intensity, insider ownership, entrenched insider ownership (dummy), relatedness (dummy), bidder size, stock payment (dummy)	Acquirors with higher R&D intensity and insider ownership at the time of the announcement realized greater abnormal returns while those with higher entrenched insider ownership realized lower abnormal returns.
Kang (1993)	119 acquisitions of US targets by Japanese firms from 1975 to 1988 (also divided into 2 sub-periods- 1975 to 1985 and 1986 to 1988)	Various	Bidder: Main bank is owner/lender (dummy), % bank own, % corporate own, % investor own, loan/MV, other debt/MV, leverage, tax 1981 (dummy), tax 1986, %management own, ln MV, relative MV (target vs. bidder), merger (dummy), unit acquisition (dummy), manufacturing (dummy), competitive bid (dummy) Target: % management own, % bidder own, % block own by bank, % block own by corporate, % block own by investment, ln MV, US target (dummy)	Japanese acquirers reported significant positive wealth effects in the (-1, 0) and (-1, +1) observation windows. Loans and other debt as a proportion of market value, leverage, exchange rates, and bidder's size (as measured by MV) and industry contributed to improved shareholder value. The tax changes in 1986 and multiple bidders, on the other hand, destroyed shareholder value.
Markides & Ittner (1994)	276 clean acquisition announcements by U.S. firms from 1975-1988	Various	Acquirer income, acquisition during crash (dummy), industry concentration, relatedness (dummy), bidder R&D intensity, bidder advertising intensity, US\$ strength, prior international experience (dummy), cash payment (dummy), acquirer profitability, English speaking (dummy), relative size (target vs. bidder), tax 1981 (dummy), relative GDP growth, stock market correlation, industry profitability, tax 1986 (dummy), host culture (Hofstede)	Bidding firms experienced significant abnormal returns of 0.32%, 0.54%, and 0.49% in the (-1, 0), (-1, +3), and (-2, +3), windows respectively. Industry concentration, relatedness, advertising intensity, a strong US dollar, and prior international experience all resulted in enhanced shareholder wealth effects while acquirer profitability, relative size, and tax benefits had negative effects.

Table 2.1 – *Continued*

Manzon et al. (1994)	103 acquisitions by U.S. firms from 1975-1983	(-1, 0)	Tax effect of acquisition/MV bidder, host development (dummy), prior presence in host (dummy), relatedness (dummy)	Tax effects and lower target country development significantly increased bidding firm shareholder wealth.
Datta & Puia (1995)	112 acquisitions by U.S. firms from 1978 to 1990	(-1, 0) (-5, +5) (-10, +10) (-15, +15) (-20, +20) (-30, +30)	Relatedness (dummy), cultural distance	Significant and increasing negative returns for all windows (except (-10, +10) window), ranging from -0.42% to -2.54%, were observed. Unrelated acquisitions and high cultural distance resulted in lower abnormal returns.
Doukas (1995)	463 acquisitions (270 firms with high q) by 234 U.S. firms from 1975 to 1989	(-1, 0)	Prior presence in host country (dummy), host country development (dummy), relatedness (dummy), exchange rate (dummy), cash payment (dummy), excess cash flow (dummy)	Acquirors with higher q generated significant positive returns in the (-1, 0) window. Initial entry to a target country and entry into less developed host countries related positively to shareholder value while exchange rates and free cash flow were negatively associated with shareholder value.
Cakici, et al. (1996)	195 acquisitions of US firms by various firms from 1983 to 1992	(-10, +10) (-10, +1) (0, +1)	Tax reform (dummy), relative size (target vs. bidder), competitive bid (dummy), bidder foreign/total sales, FX strength (target vs. bidder), target R&D intensity	Significant positive announcement returns up to 1.96% was found but no effects for control group of US acquiring firms were observed. Tax reforms and exchange rates were negatively associated with abnormal returns. Acquirors with targets between 10% and 25% of their size and with higher foreign exposure and transactions with no multiple bidders resulted in enhanced shareholder wealth.
Eun et al. (1996)	117 acquisitions of US firms by various firms from 1979 to 1990	(-5, +5)	Bidder country (dummy), acquirer R&D intensity, target R&D intensity, combined R&D intensities, relative market value (target vs. bidder), prior presence in host country (dummy), FX strength (target vs. bidder), related (dummy), competitive bid (dummy), transaction value, tender offer(dummy)	Overall wealth effects from cross-border announcements were negative, but driven by European acquirers and attenuated by Japanese acquirers. Target's R&D intensity and combined R&D intensity translated into positive shareholder gains.

Table 2.1 – Continued

Reuer & Miller (1997)	88 internalized IJVs by US firms from 1988 to 1994	(-2, +2)	Inside ownership (total or divided into 3 levels), bidder free cash flow, leverage, total assets	No significant abnormal return was observed in the (-2, +2) window. Inside ownership greater than 0.25 and the interaction between free cash flow and leverage had positive wealth effects.
Markides & Oyon (1998)	236 European (189, 81 from UK) and Canadian (47) acquisitions by U.S. firms from 1975 to 1988	Various	Stock market correlation, bidder industry concentration, host culture (Hofstede), relatedness (dummy), acquiror prior international experience (dummy), bidder advertising intensity, bidder R&D intensity, FX strength, bidder profitability, host barriers, acquisition by US firms in host, number of block owners, % board insiders	Significant abnormal returns of 0.38% and 0.59% were observed in the (-1, 0) and (-1, -3) windows, primarily driven by European, non-UK acquisitions. Stock market correlation, industry concentration, related acquisitions, prior international experience, R&D intensity, and a strong US dollar all improved shareholder value while acquiror profitability and board dependence destroyed shareholder value.
Cybo-Ottone & Murgia (2000)	15 EU acquisitions by fellow EU firms from 1988 to 1997	(-10, 0)	Domestic vs. cross-border	No significant shareholder wealth effects were observed for cross-border acquisitions. Additionally, abnormal returns were not significantly different from domestic acquisitions.
Amihud et al. (2002)	214 (19 from the US) bank mergers from 1985 to 1998	(-10, +1)	Changes in total risk, systematic risk (world, home, host countries), and beta for US, UK, European, rest of the world acquirors	Abnormal return to bidders was -0.98%, driven by losses from UK acquirers. Slightly positive returns were observed when the firm's risk was slightly higher than that of the home country market.
Seth, et al. (2002)	100 acquisitions of US firms by various firms from 1981 to 1990	(-10, +10)	Intangibles (R&D, advertising, and marketing expenses/sales), relative size, GDP growth, reduction of variance, bank-based governance, group-based governance, multiple bid	No significant shareholder wealth effects were observed. In the synergy sub-group, wealth effects were positively affected by intangibles. In the managerialism sub-group, wealth effects were positively influenced by relative size, GDP growth, bank governance and negatively influenced by variance reduction and multiple bids. Finally, in the hubris subgroup, wealth effects were positively related with bank/group governance and variance reduction.

Table 2.1 – Continued

Goergen & Renneboog (2003)	56 EU acquisitions by other EU countries from 1993 to 2000	(-1, 0) (-2, +2) (-40, 0) (-60, +60)	Domestic vs. cross-border	Overall positive wealth effects of 2.38% and 3.09% were observed for the 2 shortest periods. These results were driven by abnormal returns from acquisitions from UK and Benelux.
Conn, et al., (2005)	1,140 acquisitions of UK firms from 1984 to 1998	(-1, +1)	Domestic vs. cross-border, public vs. private target, noncash payment (dummy), relative size, relative size*noncash, value acquirer (dummy), glamour acquirer (dummy), high-tech acquirer (dummy), target is subsidiary (dummy), related acquisition (dummy), acquirer size, multiple bid (dummy), hostile (dummy), culture difference	Announcement of cross-border acquisitions resulted in positive abnormal returns of 0.33%, driven by returns in private acquisitions. Glamour acquirers generated more value in cross-border acquisitions of public firms while value and high technology acquirers and a higher cultural difference resulted in greater value creation in the cross-border acquisition of private firms.
Gleason et al., (2005)	97 acquisitions by US (47) and non-US (50) banks from 1981 to 1998	(-1, +1) (-1, 0)	.Majority acquisition (dummy), US bidder (dummy), relative GDP (home vs. host), relative PCI, host rule of law, ROE, bidder market value (ln), bank (dummy), transition economy (host, dummy), change in total risk, change in systematic risk	Positive shareholder wealth effects of 0.61% and 0.48% in the 3-day and 2-day windows around the announcement date were observed, mostly from abnormal returns by non-US acquirers. Acquirer size and origin from the US, together with unrelated acquisitions and into transition economies, all contributed negatively to shareholder value. Total risk, meanwhile, had positive effects on firm value.
Gregory & McCorriston (2005)	333 acquisitions by UK firms from 1984 to 1995	(-3, +1)	US acquisition (dummy), EU acquisition (dummy), 1986 tax (dummy), FX strength (target vs. bidder), R&D intensity, advertising intensity, relatedness (dummy), hostile (dummy), prior sales in host	No significant shareholder wealth effects were associated with the announcement of acquisitions. Acquisitions from EU, exchange rate, US tax laws, and prior sales in host were negatively associated with abnormal returns. Among US acquisitions, industry advertising intensity had positive effects on shareholder wealth.

Table 2.1 – Continued

Moeller & Schlingemann (2005)	383 acquisitions by US firms from 1985 to 1995	(-1, +1)	Domestic vs. cross-border, time period (1985-1990, 1991-1995)	No significant wealth effects in the (-1, +1) window. In the 1991-95 period, abnormal returns from cross-border acquisitions were significantly lower when compared to returns from domestic acquisitions.
Meschi & Metais (2006)	291 U.S. acquisitions by French firms from 1988 to 2004	(-1, +1) (-2, +2) (-3, +3)	Acquisition experience in host, acquisition homogeneous experience in host, transaction value, relative size (target vs. bidder), stock payment (dummy), bidder size, relatedness (dummy), target status (dummy)	Positive abnormal returns ranging from 0.45% and 0.78% were observed. Bigger targets (in relation to bidders) and payments made in the form of stock were negatively associated with shareholder value.
Wooster (2006)	383 acquisitions by US firms in transition economies from 1989 to 1999	(-1, +1)	IJV vs. cross-border acquisition vs. non-FDI, 2 sub-periods (1989 to 1992 and 1993 to 1997)	No significant wealth was created in the (-1, +1) window for the entire study period but a significant positive wealth effect was observed in the 1989-1992 period. Announcement effects of non-FDI and IJVs into transition economies were more positive when compared to cross-border acquisitions.
Black, et al. (2007)	360 acquisitions of US firms from 1985 to 1995	(-5, +1) (-5, +5)	Univariate test	Cross-border acquisition announcements led to significant wealth effects of 0.90% and 1.50% in the (-5, +1) and (-5, +5) windows respectively
Freund, et al. (2007)	194 US firms acquiring foreign targets from 1985 to 1998	(-1, +1)	Industrial diversification, global diversification, industrial and global diversification, Tobin's q (acquirer), shareholder protection (host country), cash payment (dummy), acquisition value/acquirer's asset book value	Significant positive wealth effect of 1.37% was observed for the (-1, +1) window. Acquiring firms with higher growth opportunities (q), diversification (global, industrial, or both), and shareholder protection and paid with non-cash experienced lower abnormal returns.

Table 2.1 – Continued

Francis, et al. (2008)	1,461 acquisitions by U.S. firms from 1990 to 2003	(-1, +1)	Target from financially segmented market (dummy), host country development, host originate from English law (dummy), host economic freedom, host stock market capitalization, acquirer size, cash payment (dummy), public target (dummy), transaction value, relatedness (dummy), high tech (dummy), acquirer beta, acquirer S&P rated (dummy), acquirer credit AA rating (dummy), acquirer MTB, acquirer free cash flow, host creditor rights, host political stability, host credit rating	Significant positive wealth effect of 0.96% was registered by cross-border acquisition announcements. Acquisitions that involved targets from segmented and free markets and acquiring firms that were larger, with higher beta and higher credit, resulted in higher abnormal returns. Additionally, acquiring private targets and from a target host country with lower development, its origins in English law, and low stock market capitalization also resulted in higher abnormal returns.
Aybar & Ficici (2009)	433 acquisitions by firms from the emerging markets from 1991 to 2004	Various	Bidder total assets (log), target status (dummy), level of control, acquisition value/bidder market value, target country development (dummy), geographical/cultural proximity (KOF, Hofstede indices), bidder foreign/total sales, prior presence in host country, high tech acquirer industry (dummy), governance using ADRs (dummy), bidder strategic orientation (dummy), acquirer regional domicile (dummy)	No significant shareholder wealth effect was related to the announcement in the (-10, +10) window but a significant negative wealth effect was observed for the 3-day window around the announcement date. For abnormal returns in the (-1, +1) windows, private targets and acquisition size were positively associated with shareholder gains while governance was negatively associated with shareholder gains.
Chakrabarti, et al. (2009)	112 cross-border acquisitions from 1991 to 2004	(-1, +1)	Friendly acquisition (dummy), tender offer (dummy), cash payment (dummy), number of bidders, acquirer MV, target openness, PCI difference, forex volatility, bilateral trade, governance difference, cultural distance, similar religion (dummy), similar language (dummy), similar legal origin (dummy)	Significant abnormal returns of 0.71% were observed among acquiring firms. Culture similarities (lower cultural distance, language and legal origin similarities but not religion similarity) had positive effects on announcement abnormal returns.

An examination of the studies on long-term returns associated with cross-border acquisitions reveals equivocal findings. Early studies by Conn and Connell (1990), Danbolt (1995), and Eckbo and Thorburn (2000) examined long-term bidder wealth effects associated with cross-border acquisitions for a period of up to one year after the acquisition announcement date. Interestingly, Conn and Connell's (1990) research found that shareholders of U.S. firms do not gain in cross-border acquisitions over the (-12, +12 month) window. Likewise, in their study involving acquisitions of Canadian firms by U.S. acquirors, Eckbo and Thorburn (2000) found that such acquisitions resulted in a negative, albeit non-significant, shareholder returns over the (+1, +12 month) period. Although Danbolt's (1995) used a different time frame (-8, +5 months) in analyzing the effects of acquisitions of U.K. targets by U.S. firms³, she too observed no significant changes in shareholder wealth for the bidding firms. The computation of shareholder wealth effects for all these studies is based on the cumulative abnormal returns (CARs) using the market model. However, the use of the market model in the assessment of long-term returns is fraught with problems. As Conn et al. (2005) point out, these include parameter instability (Coutts, Mills, & Roberts, 1997), and susceptibility to statistical biases (Lyon et al., 1999). In addition, as Fama and French (1993) argue, a multi-index model (e.g., the Fama-French 3-factor model), is superior to a simple market model because it assumes that the return patterns of sample firms closely resemble other firms with similar market capitalization and book-to-market value. Also, because it is summed monthly, CARs calculated for longer windows yield positively biased statistics; an alternative long-term abnormal return measure, the buy-and-hold abnormal return (BHAR), is compounded monthly and yields negatively biased statistic (Barber & Lyon, 1997). However, while the use of a control firm portfolio as a benchmark results in

³ Finding cited used the market model. Similar result were obtained using the index model was found.

Table 2.2 Key Studies on Long-Term Bidder Wealth Effects of Cross-Border Acquisitions

Study	Data	Window	Variables examined	Findings
Conn & Connell (1990)	38 US acquisitions by UK firms and 35 UK acquisitions by US firms from 1971 to 1980	Domestic, international market model, (-12, +12 months)	Estimation based on premerger, post-merger, and pooled (pre and post) periods	Bidder gains in the (-12, +12) window were inconclusive depending on the period examined—whether premerger (negative, sig.), post-merger (positive, sig.) or pooled (negative, not significant. for UK acquirers and positive, not significant for US acquirers).
Danbolt (1995)	48 UK acquisitions by US (20) and European (28) firms from 1986 to 1991	Market, index model, (-8, +5 months)	Uncompleted (dummy), multiple bid (dummy), revised bid (dummy), cash payment (dummy), relative size (target vs. acquirer), acquirer size	U.S. acquirers had a 5.13% but non-significant return from acquisition over the (-8, +5 month) period while European acquirers posted significant shareholder losses (-26.81%) in the same window. Multiple bidders had a negative effect on shareholder wealth while target size relative to acquirer and acquirer size had positive effects.
Eckbo & Thorburn (2000)	390 Canadian acquisitions by US firms from 1964 to 1982	Market model, +12 months post-announcement date	Relatedness, acquisition experience (from 1964 to 1983)	NYSE-listed U.S. acquirers generated -3.72%, non-significant returns in the 12 months following the transaction. Related acquisitions (at the 2-digit SIC level) realized superior shareholder returns when compared to unrelated acquisitions. Acquisition experience and acquirer size appeared to have a non-linear effect on shareholder wealth.
Andre et al. (2004)	90 acquisitions by Canadian firms from 1980 to 2000	CTAR, +36 months post-completion date	Cross-border vs. domestic	Canadian acquirers had negative and significant returns of -1.15%, significantly lower returns than domestic counterparts, and 3 years after the cross-border acquisition.
Aw & Chatterjee (2004)	29 US acquisition by UK firms from 1991 to 1996	Market model, market adjusted model, +6, +12, +18, +24 months post-announcement date	Cross-border vs. domestic; US targets, Continental Europe targets	Using the market model, while posting negative returns from 6 months following the transaction, U.K. acquirers had significant shareholder losses for their U.S. acquisitions of 11.29% and 22.36% in the 18 and 24 months post-acquisition respectively and for their European acquisitions, 29.35% in 24 months.

Table 2.2 – Continued

<p>Conn et al. (2005)</p>	<p>1,140 acquisitions by UK firms from 1984 to 1998</p>	<p>BHAR, CTAR, +36 months post-completion date</p>	<p>Domestic vs. cross-border, public vs. private target, noncash payment (dummy), relative size, relative size*noncash, value acquirer (dummy), glamour acquirer (dummy), high-tech acquirer (dummy), target is subsidiary (dummy), related acquisition (dummy), acquirer size, multiple bid (dummy), hostile (dummy), culture difference</p>	<p>Cross-border acquisitions by U.K. firms resulted in marginally significant -13.37% returns after 3 years, driven by losses from acquiring public targets. When acquiring public targets, glamour acquirers generated more shareholder wealth. When acquiring public targets, value and high-tech acquirers and high culture difference resulted in more shareholder destruction.</p>
<p>Gregory & McCorrison (2005)</p>	<p>333 acquisitions by UK firms from 1984 to 1995</p>	<p>BHAR, +12, +36, +60 months post-completion date</p>	<p>US targets, EU targets, Rest of the World targets, relatedness, acquirer size, US tax regime, FX strength, R&D intensity, advertising intensity, hostile acquisition (dummy), prior sales in host</p>	<p>Overall, cross-border acquisitions by U.K. firms did not generate any significant losses for acquiring firm shareholders in the 1-, 3- and 5-year post-acquisition periods. Acquisitions from the U.S. posted significant losses in the longer periods (9.36% in 3 and 27.09% in 5 years). This was in contrast to the significant gains realized with the acquisitions from rest of the world in the same periods (21.31% and 32.15% in 3 and 5 years). Overall, unrelated acquisitions generated significant losses 5 years post-acquisition and small acquirers realized more positive value in the 3 and 5 years after the acquisition. Acquiror R&D intensity and hostile acquisitions generated greater shareholder gains while prior experience (sales) in host country results in wealth losses.</p>
<p>Gleason et al. (2006)</p>	<p>233 acquisitions by US firms from 1984 to 1998</p>	<p>BHAR, +6, +12, +18 months post-announcement date</p>	<p>Relatedness, target country development</p>	<p>Cross-border acquisitions generated significant gains of 5.89% and 7.29% for bidders in the longer windows of (+1, +12) and (+1, +18) but no significant returns were observed in (+1, +6 months) window. Unrelated (scale) acquisitions resulted in positive shareholder wealth effects for the later 2 periods. Both acquisitions into developed and developing countries also resulted in shareholder gains after 1 year post-acquisition, with acquisitions in developed (developing) markets outpacing developing (developed) markets in the +12, +18 months window.</p>

Table 2.2 – Continued

Black et al. (2007)	361 acquisitions by US firms from 1985 to 1995	BHAR, +12, +36, +60 months post-completion date	Domestic vs. cross-border	While no significant losses were generated 1 year post-acquisition, U.S. acquirers had significant losses of 13.2% and 22.89% 3 and 5 years post acquisition, higher than domestic acquisitions.
Mueller & Yurtoglu (2007)	8,107 acquisitions from 1981 to 2002	Market model, +250, +500, +750 days post-announcement date	Acquirer country of origin	Cross-border acquisitions destroyed shareholder wealth amounting to -5.3%, -9.3%, -18.2% for their acquirers in the (-10, +250 day), (-10, +500 day) and (-10, +750 day) windows respectively. Acquirers from Canada, New Zealand, Belgium, Finland, and Switzerland registered two-digit losses throughout the 3 periods studied.
Boubakri et al. (2008)	30 acquisitions by US insurance firms from 1995 to 2000	BHAR, CTAR, +36 months post-announcement date	Domestic vs. cross-border	U.S. acquirers posted a 24.7% gain on their cross-border acquisition 3 years thereafter, significantly lower than returns on domestic acquisitions.
Chakrabarti et al. (2009)	1,138 acquisitions from 1991 to 2004	BHAR, +12, +24, +30, +36 months post-completion date	Friendly acquisition (dummy), tender offer (dummy), cash payment (dummy), number of bidders, acquirer size, target openness, PCI difference, FX volatility, bilateral trade, corporate governance difference, cultural distance, similar religion (dummy), similar language (dummy), similar legal origin (dummy)	While generating increasing positive yet non-significant returns within 1 to 2 ½ years following the transaction, cross-border acquisitions posted a significant gain of 9% to the bidder's shareholders after 3 years post-acquisition. Friendly and cash financed acquisitions and governance differences all had a positive effect on value creation. Similarity in language and culture was found to have negative effects on shareholder wealth.
Lin et al. (2009)	450 acquisitions by US firms from 1992 to 1996	Market model, size/BTM/momentum adjusted portfolio, +12, +24, +36, +48, +60 months post-announcement date	Use of derivatives (dummy), number of derivatives, number of unique derivative contracts, amount of derivatives, cash payment (dummy), relative acquisition size, full acquisition (dummy), relatedness (dummy), acquirer size, leverage	Foreign acquisitions resulted in significant shareholder losses, with relatively lower losses in the shorter periods (-4.06% in 1 st and -7.28% in 2 nd year) and increasing losses in the medium-term (-10.12% in 3 rd and -9.99% in 4 th year). In the 5 th year, U.S. acquirers still had negative, but non-significant, shareholder return of 1.52%. The use of derivatives, along with the number types, contracts, and amount, had positive effects on shareholder wealth. Larger transaction size and acquirer size generated more shareholder gains while related acquisitions resulted in more shareholder losses.

measurement bias being eliminated in BHAR, measurement bias in the context of long-term CARs remains because it uses a market reference portfolio as a benchmark (Barber & Lyon, 1997).⁴

Studies conducted over the past five years (i.e., Black et al., 2007; Boubakri, Dionne, & Triki, 2008; Gleason et al., 2006; Lin, Pantzalis, & Park, 2009) have provided findings that, on first glance, appear to be inconclusive. However, some trends emerge upon closer examination. Studies by Black et al. (2007) and Lin et al. (2009) investigated shareholder returns in international acquisitions by U.S. firms for post-acquisition periods of up to 60 months and found significant acquisition related losses from the perspective of bidding firm shareholders. In contrast, studies by Gleason et al. (2006) and Boubakri et al. (2008) found significant shareholder gains for U.S. acquiring firms in foreign acquisitions. In addition, except Lin et al. (2006), all the other studies have used the BHAR methodology. Lin et al. (2006) used multi-index models. One primary difference relates to the use of samples that were restricted to specific industries in studies by Gleason et al. (2006) and Boubakri et al. (2008). While Gleason et al.'s (2006) study involved acquisitions by U.S. banks, Boubakri et al. (2008) studied foreign acquisitions by U.S. insurance firms. With both studies indicate shareholder gains it is quite likely that industry specific factors may be an important factor in explaining the variance in returns experienced by acquiring firms in cross-border acquisitions.

There appears to be greater congruence among studies examining the long-term returns associated with cross-border acquisitions involving non-U.S. acquirors. Of the eight studies identified in Table 2.2, five (André, Kooli, & L'Her, 2004; Aw & Chatterjee, 2004; Conn et al., 2005; Danbolt, 1995; Mueller & Yurtoglu, 2007) show significant negative returns from the bidding firm's perspective. In one of the earliest studies on the long-term wealth effects of international acquisitions, Danbolt (1995) found that such acquisitions resulted in significant

⁴ A more detailed discussion on how BHAR eliminates the negative measurement bias is found in the next chapter.

negative returns for European firms when they acquired firms in the U.K. Similar results were obtained in more recent studies of acquisitions by U.K. firms by Aw and Chatterjee (2004) and Conn et al. (2005). Likewise, Mueller and Yurtoglu (2007) reported negative returns of 18% in the 3-year post-acquisition announcement period. Gregory and McCorrison's (2005) study has also documented negative (but non-significant) shareholder returns for U.K. acquiring firms; however, a closer inspection revealed that while acquisitions by U.K. firms of U.S. targets resulted in significant shareholder losses in the 3 year period following the acquisition, returns associated with acquisition of firms in other countries were significant and positive for the same time period. They attributed this result to the more competitive market for corporate control in the U.S. The findings of Chakrabarti et al. (2009) stand out in that they found shareholder returns to bidding firms in international acquisitions to be consistently positive and increasing in the one, two and three year time horizons, culminating in total gains of 9% in the three years following the acquisition. However, the median shareholder returns were negative over the different periods, indicating that the mean positive returns were a function of a few cross-border acquisitions posting large gains.

From a methodological perspective, Chakrabarti et al. (2009) employed a multi-index market model similar to that used by Andre et al. (2004), Conn et al. (2005) and Gregory and McCorrison (2005). But unlike the latter studies (which measured acquiring firm performance against benchmarks values associated with control firms or portfolios), comparison was based on the firm's country market index. This anomaly can probably be explained by the fact that firms which engage in cross-border acquisitions are likely to be larger and more efficient than the average firm in a country, resulting in the upward bias in the average bidder returns.

In sum, as researchers use longer time frames and more sophisticated methodologies to examine acquisition returns over extended periods, there is some consensus that cross-border acquisitions do not create shareholder value in the long term. Because of the extended time periods often necessary to assimilate acquisitions (Datta, 1991), it takes time for the true

effects of acquisitions to emerge. As such, it is important that studies on cross-border acquisitions make greater use of longer time frames (i.e., at least 1 year) in examining value creation associated with such transactions.

In the following section, I examine research related to the factors that have been hypothesized to influence shareholder value in cross-border acquisition in prior research.

2.2 Contextual Factors Influencing Shareholder Value Creation in Bidding Firms

2.2.1 Geographical Diversification

Some of the early studies on the performance of cross-border acquisitions were based on the argument that value creation results from lowered risks arising out of geographic diversification. Because markets tend to be uncorrelated, geographical diversification via acquisitions enable firms to stabilize their revenue streams (Caves, 1982). This argument, however, assumes that markets are segmented and capital flows are restricted, thereby making it costly for investors to minimize their portfolio risk through international diversification. However, evidence has been equivocal. Francis et al. (2008) found that acquisitions of firms in financially segmented markets, i.e. non-correlated markets, generated greater short-term shareholder wealth. On the other hand, Markides and Oyon (1998) observed a positive relationship between correlation among stock markets and in the bidding firms' ability to create shareholder value. However, studies by Markides and Ittner (1994) and Seth et al. (2002) found no significant relationship between geographic diversification and value creation.

2.2.2 Firm Tangible and Intangible Assets

Studies have examined the effects of a firm's intangible assets, often measured by R&D and advertising intensity, on shareholder wealth effects in cross-border acquisitions. Findings have been mixed, with Markides and Oyon (1998) and Morck and Yeung (1992) observing R&D intensity, but not advertising intensity, to be associated with greater shareholder value creation. On the other hand, studies by Markides and Ittner (1994) and Gregory and McCorrison (2005) found no effects for R&D intensity and a marginally positive association

between advertising intensity and value creation. Moreover, the study by Wooster (2006) failed to find any significant relationship between R&D or advertising intensity and returns to bidding firm shareholders. Furthermore, using a dichotomous variable to signify a firm's technology status, Conn et al. (2005) demonstrated a strong positive relationship between high technology and shareholder value. On the other hand, Aybar and Ficici (2009) found a negative, albeit weak, relationship. There is also mixed evidence on the relationship between target firms' R&D and/or advertising capabilities and short-run value creation for bidding firm shareholders. While Cakici et al. (1996) did not find any evidence of such relationship, studies by Eun et al. (1996) and Seth et al. (2002) indicate that returns were higher for bidders when they acquired targets with higher levels of R&D intensity.

2.2.3 Governance

Board non-independence and ownership are the only governance factors featured in extant research on foreign acquisition-related shareholder value creation. In the context of the former, Markides and Oyon (1998) found that a higher proportion of inside directors on the board had a negative impact on shareholder value. Kang's (1993) study on the effects of ownership found that among Japanese acquirers, returns to shareholders were unaffected by ownership, be it institutional or managerial. Markides and Oyon (1998) also found the number of block holders to have no significant effect on shareholder wealth. Among U.S. acquirers, greater insider ownership has been linked to shareholder value creation in acquisitions (Morck & Yeung, 1992; Reuer & Miller, 1997). However, questions have been raised on the optimal level of ownership. While Reuer and Miller's (1997) research indicates that ownership in excess of 25% is beneficial, the study by Morck and Yeung (1992) found that insider ownership in excess of 20% is detrimental to acquisition performance.

2.2.4 Environmental and Country Conditions

In addition, some important findings emerge in the extant research on the influence of host country conditions on bidding firm returns. There is some evidence that acquisitions in developing countries, where inputs such as labor is cheaper and markets are not saturated, are associated with superior performance both in the short-run (Doukas, 1995; Doukas & Travlos, 1988; Manzon, Sharp, & Travlos, 1994) and in the long-run (Gleason et al., 2006). Other environmental factors that have been empirically examined but indicate no influence on bidder shareholder value include host country GDP growth (Gleason, McNulty, & Pennathur, 2005; Mathur, Rangan, Chhachhi, & Sundaram, 1994; Wooster, 2006), economic freedom (Conn et al., 2005), and the quality of accounting standards (Conn et al., 2005).

A number of studies have sought to examine the effects of cultural distance (the difference between the acquirer and acquired firms' country cultures) and value creation. The underlying argument in these studies has been that low cultural distance should translate into superior returns since it mitigates the liability of foreignness (Zaheer, 1995) and decreases post-acquisition integration costs (Barkema, Bell, & Pennings, 1996). Findings of studies by Chakrabarti et al. (2009) and Datta and Puia (1995) indicate a negative relationship between cultural distance and short-term shareholder returns. Further, Markides and Ittner (1994) and Markides and Oyon (1998) examined the effects of only the host culture using just one of Hofstede's (1980) dimensions, namely, masculinity, and found only tenuous, albeit positive, short-term wealth effects. However, research on the effects of culture distance on the long-term shareholder value creation has provided inconsistent results. While Conn et al.'s (2005) research indicates a negative relationship between cultural distance and bidding firm shareholder value in the three year period following an acquisition, the findings of Chakrabarti et al. (2009) suggest otherwise. They surprisingly found that high cultural distance to be associated with shareholder gains in the long-run.

In sum, a review of extant research indicates inconclusive findings on the performance effects of cross-border acquisitions from the perspective of bidding firms. However, most studies indicate that cross-border acquisitions are not value creating strategies for firms making such acquisitions. Moreover, evidence on the influence of various factors (e.g., cultural distance, relatedness) is also not conclusive. In the following section, I discuss some of the reasons that have been offered on why cross-border acquisitions often fail to create value for acquiring firm shareholders.

2.2.5 Managerial Hubris and Opportunism

Based on the managerial opportunism argument, scholars have argued that cross-border acquisitions often fail to create value because managers may use such transactions to further their own interests rather than those of shareholders. The managerial opportunism argument posits that managers are growth-maximizers who often elect to diversify firms beyond their optimal size to the detriment of shareholders' interests (Jensen, 1986). Several reasons have been provided for this behavior. For one, managing a bigger firm provides managers with personal benefits such as higher compensation, (e.g., Tosi & Gomez-Mejia, 1989; Wright, Kroll, & Elenkov, 2002a), power, prestige and job satisfaction. Second, firm diversification reduces the bankruptcy risks and consequently reduces the employment risk of involved managers (Amihud & Lev, 1981). Consequently, managers might be motivated to pursue cross-border acquisitions even when they recognize that such acquisitions may not create value for their shareholders. Third, the hubris hypothesis proposed by Roll (1986) suggests that managers make mistakes – that their belief and confidence in the acquisitions they pursue results in them overpaying for target firms resulting in loss of shareholder wealth.

There has been very limited research on the effects of managerialism on shareholder value in acquisitions. Doukas (1995) and Kang (1993) found that having less than average free cash flow and higher leverage results in higher bidder gains. However, no such relationship was observed by Reuer and Miller (1997). In addition, Gleason et al. (2000) and Lin et al. (2009)

studied the effects of firm leverage on value creation and found no significant relationships in the short or the long-term. Associating transition economies with a lax shareholder rights protection regime, Gleason et al. (2005) observed that the acquisition of firms in such economies did not materially impact shareholder value in the short-run. However, Chakrabarti et al. (2009), using La Porta, Lopez de Silanes, Shleifer, and Vishny's (1998) shareholder right index, found a positive relationship between differences in the national governance (shareholder right index) and long-run shareholder value.

In conclusion, the body of work on the wealth effects of cross-border acquisitions offers limited consensus on the factors that determine shareholder value for bidding firms. And, while the literature is limited in its exploration of governance-related factors, findings related to effects of inside ownership provide a glimpse of how effective governance mechanisms may help curb managerialism and protect shareholders interests in the context of acquisitions (Boubakri et al., 2008).

2.3 Theoretical Perspectives and Empirical Evidence on Effects of Firm Governance on Firm Strategy and Performance

The relationships between governance mechanisms and firm performance have been extensively researched in the context of strategies such as corporate diversification (Lane et al., 1998; Amihud & Lev, 1981; Denis et al., 1997), divestitures (Bergh, 1995), internationalization (Mishra & Gobeli, 1998) and international alliances (Reuer & Miller, 1997). But, as the preceding review demonstrates, research on the relationship between firm governance and performance in the context of cross-border acquisitions has been limited. For the sake of parsimony, my review of the governance literature is limited to the role of firm governance in the context of corporate diversification and associated strategies⁵.

⁵ For a more exhaustive review of the literature on the relationships between governance attributes and firm performance please see Dalton et al. (1998; 1999; 2003) and Bhagat and Black (1999).

2.3.1 Board Structure

2.3.1.1 Board size

While greater monitoring of management can be expected when firms have larger boards, the quality of monitoring may suffer given coordination and communication challenges along with free-rider problems. On the positive side, larger boards have access to greater levels of information and expertise that allows directors to perform their advisory and monitoring roles more efficiently (Lehn, Patro, & Zhao, 2009). Empirical findings on the effects of board size on firm performance have been mixed. A meta-analysis of the empirical literature by Dalton et al. (1999) however, indicates a systemic positive relationship between board size and firm performance. This finding contradicts those of Yermack (1996) who observed a negative relationship between board size and firm performance among sufficiently large U.S. firms. On the other hand, studies by Eisenberg, Sundgren, and Wells (1998) and Kroll, Walters, and Wright (2008) indicate no significant relationship between board size and firm performance. In the context of domestic acquisitions, studies by Ben-Amar and Andre (2006) and Faleye and Huson (2002) also found a negative relationship between board size and short-term acquisition abnormal returns. On the other hand, the findings of Coles, Daniel, and Naveen (2007) and Bauguess and Stegemoller (2008) indicate that firms with larger boards that engage in diversification (via acquisitions or otherwise) exhibit superior financial and market performance. In summary, given these equivocal findings, the effect of board size on overall firm performance is unclear.

2.3.1.2 Board independence

Agency theorists have long argued that good corporate governance involves a higher proportion of outsiders on the board. The underlying assumption is that independent outsiders who are not beholden to the CEO are in a better position to protect and promote the interests of shareholders. However, as with board size, research on the relationship between board independence and performance has produced mixed findings. Studies (e.g., see Dalton et al.,

1998 for a review) do not indicate a systematic positive relationship between board independence and firm financial performance. That is true even in the context of acquisitions. Byrd and Hickman (1992) tested the effects of outside directors on bidder abnormal returns and concluded that the relationship was not linear. They found that the positive relationship between the percentage of independent outsiders (those without any other affiliation, personal or professional, with the firm), and acquisition performance was stronger when independent directors constituted between 40 and 60% of the board than when it was less than 40%. However, over 60%, the relationship became strongly negative, leading the authors to conclude that having too many outsiders may be detrimental to shareholder value. Subrahmanyam et al. (1997), studied acquisitions in the banking industry and found an overall negative relationship between the proportion of outside directors and short-term shareholder value. Bauguess and Stegemoller (2008) also concluded that insider-dominated boards resulted in greater returns from the perspective of acquiring firms. So do Dutta and Jog (2009). Their study on acquisitions by Canadian firms found that bidding firms with a higher proportion of insiders on the board experienced greater shareholder value creation three years following the acquisition. In addition, You et al. (1986) found that a higher proportion of outsiders led to superior returns for domestic acquiring firms. Likewise, Ben-Amar and Andre (2006) found board independence to be positively associated with short-term wealth creation from the perspective of bidding firms. However, overall the findings associated with the effects of board independence on firm performance have been largely mixed.

2.3.1.3 Duality

The presence of duality, a situation where a single individual occupies the positions of CEO and the Board Chair, has typically been associated with weak governance in the governance literature. This is based on the assumption that duality alters the balance of power in the board and provides CEOs with too much control at the expense of other parties (Jensen, 1993). However, like board independence, there is limited consensus on how duality impacts

firm performance. Dalton et al.'s (1998) meta-analysis revealed no significant relationship between duality and firm performance. However, in the context of acquisitions, Boubakri et al. (2008) studied the effects of duality shareholder returns for acquiring firms in both domestic and cross-border acquisitions. They found that duality has a deleterious effect on short-term shareholder value for acquiring firms. Additionally, Masulis, Wang, and Xie (2007) also observed a negative relationship between duality and acquisition performance in the immediate and extended periods surrounding the acquisition announcement date.

2.3.1.4 Outside director tenure

It has been argued that outsiders with long tenures on the board can become ineffective monitors of management given entrenchment issues and the close relationships they tend to develop with firm management (Lipton & Lorsch, 1992). Alternatively, it has been argued that outside directors with longer tenures results in more effective monitoring given their extensive knowledge of the firm and access to firm information they are likely to have relative to other outsiders (Vafeas, 2003). On the other hand, directors who are relatively new on the board can be expected to spend a considerable amount of time and effort towards building the relationships within the board that would be vital in their effective functioning in the future (Mallette & Fowler, 1992). In addition, there have been very few studies that have examined the effects of director tenure on acquisition performance. An exception is the study by Boubakri et al. (2008) found that CEO tenure had no significant effect on the short-term shareholder value creation in acquisitions undertaken in the insurance industry.

2.3.1.5 Director reputation

Surprisingly, there have been very few studies on the relationships between director reputation (often proxied by the number of outside directorships held by directors) and firm performance. Exceptions include the study by Kor and Sundaramurthy (2009) which found a positive relationship between director reputation (assessed as the number of outside directorships held by those on the board) and firm performance. Likewise, Subrahmanyam et

al. (1997), in their sample of bank acquisitions, found the acquiring firms experienced greater shareholder wealth creation when board members, on average, held a larger number of outside directorships. In contrast, Byrd and Hickman (1992) observed no significant relationship between the average number of outside directorships and returns over the 2-day window in the context of domestic acquisitions. In other words, while the limited literature on the effects of director ownership seems to suggest that director reputation leads to superior performance, the findings of studies do not provide conclusive evidence to that effect.

2.3.2 Ownership Structure

An important aspect of corporate governance relates to the firm's ownership structure. Institutional ownership and ownership by outside directors have been associated with vigilance and effective monitoring of firm management. In addition, insider equity ownership has often been seen as motivating managers to align their interests with those of external shareholders.

2.3.2.1 Institutional ownership

Because of the large equity stakes that they hold, institutional investors have a strong motivation to monitor firm management closely so that they act in the best interests of shareholders. Institutional investors have a fiduciary obligation to maximize long-term value for their constituents and while they may not be directly involved in strategic decisions, studies (e.g., Davis & Thompson, 1994; Tihanyi, Johnson, Hoskisson & Hitt, 2003; Zahra, 1996) indicate that they often have a significant impact on the selection and monitoring of firm strategies. Since they typically have more resources at their disposal and have greater expertise required to adequately monitor firm management than other investors, institutional owners can be more effective and efficient in their monitoring role (Pound, 1988). Some suggest that institutional investors are often passive owners who choose not to actively monitor the firm they invest in due to conflict of interests from existing business relationships with the firm (Kochhar & David, 1996) or because of their relatively myopic goals (Bushee, 1998). Others (e.g., Hansen & Hill, 1991; Kochhar & David, 1996; Li & Shackell, 2001) have argued that

institutional investors are active in monitoring management towards maximizing long-term gains. This is because the large investments that institutional shareholders make in companies reduces their exit flexibility. Exit is likely to be accompanied by a major downward movement of the share price and result in substantial transactions-related capital losses. The divestment barrier, in turn, provides institutional investors a greater incentive to monitor firm management (Pound, 1992). These contrasting arguments might explain the non-significant findings obtained by Kang (1993) in his assessment of the impact of institutional ownership on shareholder wealth effects in acquisitions of U.S. firms by Japanese firms. However, there has been some support for the relationship between institutional ownership and shareholder wealth. McConnell and Servaes (1990) observed higher Tobin's Q for firms with greater institutional ownership. Also, in their studies of domestic acquisitions, both Duggal and Millar (1999) and Wright, Kroll and Elenkov (2002a) found a positive relationship between institutional ownership and short-term returns. Likewise, in their study, Chen, Harford and Li (2007) observed that firms with higher institutional ownership exhibited superior acquisition performance. In addition, such firms were also characterized by the withdrawal of bad bids that might have resulted in value destruction. Finally, in a recent study, Ben-Amar and Andre (2006) found institutional ownership to be positively associated with the market performance of acquiring firms in both domestic and foreign acquisitions. In sum, studies indicate that ownership by institutional shareholders generally result in the enhancement returns among bidding firms.

2.3.2.2 Outside director ownership

The use of equity ownership to incentivize outside directors to more actively monitor firm management is relatively recent. As such, much of the research is from the past decade. The early work of Byrd and Hickman (1992) found a positive relationship between outside ownership in bidding firms and short-term abnormal returns. Subsequent studies by Fitch and Shivdasani (2005) and Yermack (2004) too found a positive relationship between such ownership and firm performance, which was more pronounced in firms with weak governance

mechanisms (Magnan, St. Onge, & Gelinas, 2010). These results are consistent with the research of Dalton et al. (2003) which indicates a positive relationship between outsider equity ownership and firm financial performance. Further substantiation comes from the recent work of Kroll et al. (2008). They found outside director ownership to be associated with superior acquisition-related performance. In sum, there is reasonably strong evidence that outsider equity ownership contributes to superior firm performance.

2.3.2.3 Inside director/CEO ownership

According to agency theorists, one of the most effective ways by which managers' interests can be aligned with those of shareholders is having managers own significant equity in the firm (Morck, Shleifer, & Vishny, 1990). Such alignment should result in superior investment decisions and shareholder value creation. Studies by Kang (1993), Reuer and Miller (1997), Byrd and Hickman (1992) and Kroll et al. (2008) indicate a positive relationship between insider ownership and acquisition performance. In contrast, Boubakri et al. (2008) report a significant negative shareholder wealth effect for acquiring firms with higher CEO ownership. Furthermore, the study by Datta, Iskandar-Datta, and Raman (2001) on the relationship between managerial ownership and the performance of acquiring firms in domestic acquisitions found no significant relationship.

McConnell and Servaes (1990) also examined the relationship between insider ownership and performance and found that the relationship was not necessarily linear. From the perspective of managers who have limited equity ownership, personal wealth loss from underperforming acquisitions is likely to result in them foregoing acquisitions that they believe might not create value (Agrawal & Mandelker, 1987). However, at high levels of ownership, its effectiveness in curbing managerialism is diminished because of entrenchment issues. Entrenched managers, with their large ownership may feel protected from the external market for corporate control, e.g. takeovers and proxy challenges, often used to regulate their behavior (Demsetz, 1983; Stulz, 1988). Based on their sample of over 1,000 publicly traded firms,

McConnell and Servaes (1990) found a positive relationship between managerial ownership and the firm's Tobin's q but after an ownership level of 40%, the relationship became negative. Additionally, prospect theory (Kahneman & Tversky, 1979) suggests that managers become more risk averse when their ownership in the firm represents a large portion of their personal wealth. Because of undiversified equity position in the firm managers will act in a manner that minimizes the downside risk (losses resulting from a drop in share prices) choosing strategies that are more conservative and low risk. According to Wright et al. (2002b), "CEO's personal wealth concentration induces them to undertake risk-reducing firm strategies" (p. 43). This argument has been empirically supported by Capozza and Seguin (2003) who found firms investing in less risky assets and taking on less debt in their capital structure when managerial equity is high. More recently, Latham and Braun (2009) also documented the propensity of managers with large equity positions to invest in less risky innovation. Ben-Amar and André (2006), in their study of acquisitions by Canadian firms, also found evidence of this non-monotonic relationship between managerial ownership and short-term shareholder wealth effects. Some domestic acquisition studies (Ben-Amar & André, 2006; Hubbard & Palia, 1995; Hughes, Lang, Mester, Moon, & Pagano, 2003; Walters et al., 2008; Wright et al., 2002a) have found an inverse-U relationship between managerial ownership and firm acquisition performance as well. In sum, the evidence on the relationship between managerial ownership and performance points to a positive relationship. However, there is some debate on the nature of the relationship is linear.

CHAPTER 3

RESEARCH MODEL AND HYPOTHESES

3.1 Research Model

3.1.1. Dependent Variable: BHAR

Acquisition performance, whether domestic or cross-border, has been fundamentally addressed by determining the amount, beyond the acquisition premium paid, that accrues to bidder shareholders' wealth as a result of the acquisition (Cording, Christmann, & Weigelt, 2010). Traditionally, to determine this value, scholars have utilized the short-term event-study methodology to ascertain the abnormal stock market return associated with an acquisition announcement (Fama, Fisher, Jensen, & Roll, 1969). This abnormal return (AR) is essentially the difference between the expected stock price estimated using the capital asset pricing model (or, more commonly, the market model) and the actual stock price around the announcement date, once investors factor in the potential of the acquisition to contribute to the firm's future revenue stream. An advantage of using the short-term event study lies in the use of relatively short windows around the announcement date that eliminates much of the noise associated with other events that may influence the stock price. However, it also assumes that markets are fully efficient and the market reaction to an event represents an accurate reflection of the firm's future value. In other words, investors are in a position to accurately assess the impact on the firm's future cash flow from the acquisition in question (Fama, 1970). However, this view of the efficiency of capital markets has been questioned (McWilliams & Siegel, 1997; Oler, Harrison, & Allen, 2008) since it is unlikely that investors are likely to be fully informed on the long-term merits of an acquisition at the time of its announcement and be able to accurately assess its future potential and impact on stock price. Given this important limitation, it can be argued that

cumulative abnormal returns over short windows surrounding the announcement of an acquisition represent, perhaps, an inaccurate estimate of a firm's acquisition performance.

The potential contribution of acquisitions to the wealth of bidding firm's shareholders often relates to how well it is able to capture value throughout the integration process (Andrade, Mitchell, & Stafford, 2001). And since the integration process in a cross-border transaction can take longer to implement, it is desirable to use an extended time frame (one year or longer), to examine the impact of an acquisition on shareholder value from the standpoint of the bidding firm. By doing so, long-term returns becomes a more accurate measure of its future cash flow as more information about the acquisition is factored into the stock price by investors (Lubatkin, 1987). Abnormal returns are derived in a similar fashion to the short-run event studies, except they are calculated monthly and summed geometrically. However, extending the estimation period becomes problematic because of the increased noise from factors unrelated to the acquisition that may affect the firm's stock price within the selected time frame (Chatterjee, 1986). Further, methodological concerns, such as the precision of the parameter estimate and its distribution, become more pertinent as the evaluation period is lengthened (Cording et al., 2010).

It has been demonstrated that long-run abnormal returns calculated from reference portfolios or market indices (e.g., in the computation of CARs) yield misspecified test statistics from new listing bias (from newly listed firms entering the reference portfolio), rebalancing bias (from the returns in a reference portfolio calculated after being rebalanced periodically versus the sample firm abnormal return not being subjected to rebalancing), and skewness bias (from long-term returns of sample firms being positively skewed against the reference portfolio) (Barber & Lyon, 1997). Careful construction of benchmark portfolios helps eliminate such biases (Mitchell & Stafford, 2000) because both sample firm and firms in the benchmark portfolio are already listed in the event month, both are not subject to rebalancing and both are prone to positive returns (Barber & Lyon, 1997). Hence, following Lyon et al. (1999), I

constructed benchmark portfolios based on size, book-to-market, and previous performance. I then compared my sample firm's return with this benchmark portfolio to obtain a less biased measure of abnormal return. However, assessment of the statistical significance of the computed abnormal returns poses significant challenges (Andrade et al., 2001). To improve the statistical inference of whether the sample abnormal return using the benchmark portfolio is significantly different from zero, I computed a bootstrapped skewness-adjusted t-statistic as recommended by Lyon et al. (1999). According to Brav (2000), cross-dependence in the abnormal returns used in long-term event studies cannot be ignored. Hence, I controlled for the effects of cross-dependence by purging the sample of overlapping observation returns, related to subsequent acquisitions by the same firm, within the estimation window as suggested by Lyon et al. (1999). I used a 12-month observation window following acquisitions to limit the effects of other events that might impact long-run stock price of the bidder firm. Also, consistent with other studies using the BHAR methodology (Black et al. 2007; Chakrabarti et al., 2009) I used the completion date of the acquisition rather than its announcement date.

There have been two approaches that have been used in the estimation of long-term abnormal returns. One is the CTAR (calendar time abnormal return) methodology that has been advocated by Fama (1998) and the other is the BHAR (buy-and-hold abnormal return) methodology. Fama (1998) argues that the CTAR approach is superior given that the time series treatment of the monthly calendar-time abnormal returns accounts for cross-dependence among sample firms, something that the BHAR approach does not. The proponents of BHAR however, have criticized the CTAR methodology stating that the abnormal return derived using the buy-and-hold method more accurately reflects the value of investing in an average sample firm compared to an appropriate benchmark within a specified time frame (Barber & Lyon, 1997; Lyon et al., 1999). In addition, CTAR has been criticized and its lack of power in detecting abnormal performance given the averaging between "hot" and "cold" months of activity

(Loughran & Ritter, 2000). Because of the cross-sectional nature of my study, I believe the use of BHAR methodology is more appropriate.

3.1.2. Independent Variables: Firm Governance

Andrade et al. (2001) suggest that while more is known about the magnitude of long-term shareholder wealth effects associated with acquisitions, our knowledge of the mechanisms that determine the creation or destruction of value in acquisitions is, unfortunately, limited. In this study, I argue that governance structures in place in the acquiring firm represent an important determinant of the extent of shareholder value that is created in cross-border acquisitions. Most theoretical perspectives adopted by scholars to explain shareholder wealth effects of cross-border acquisitions assume that managers undertake cross-border acquisitions for economic reasons, in line with their fiduciary responsibility. However, given that cross-border acquisitions are complex, risky, and resource-intensive transactions, managers can be expected to behave in a manner that is also reflective of their own self-interests and make decisions that are consistent with their personal goals and objectives. Given potential conflict of interests, firms characterized by stronger governance mechanisms (i.e., that monitor and incentivize managers) are more likely to be successful in curbing opportunistic behavior among managers and get them to focus on value creation. That, in turn, should result in a greater likelihood of foreign acquisitions creating long-term positive shareholder value. In other words, the presence of effective governance mechanisms assures shareholders that managers will strive to achieve outcomes that are consistent with their interests (Schleifer & Vishny, 1997). The effects of governance on firm strategic moves in the international context have been examined in recent studies by Musteen, Datta and Herrmann (2009) and Datta, Musteen and Herrmann (2009). They found that firm governance mechanisms have an important impact on the choice of entry modes, including the choice between acquisitions and joint ventures. Extending their arguments towards examining the performance outcomes of cross-border

acquisitions, I examine the effects of governance structures on the bidder returns over the 12-month period following the completion of an acquisition.

The dominant theoretical perspective used in the study of firm governance literature is agency theory. With the division between ownership and control in the modern corporation (Berle & Means, 1932), agency relationships evolve between principals and agents, wherein, principals or owners delegate control to agents or managers for the day to day running of their organizations (Jensen & Meckling, 1976). Under this arrangement, top management, particularly CEOs, are responsible for making major strategic decisions (including, acquisitions) that ensure firm profitability and shareholder value creation. However, as agency theorists point out, such relationships are often fraught with significant agency problems and associated agency costs. Based on the assumption that shareholders are constrained by bounded rationality and that managers are self-serving, agency costs arise when the goals of shareholders and managers diverge and information asymmetry results in shareholders having limited access to information on the behavior of managers (Eisenhardt, 1989). For example, agency costs arise when managers who are motivated by compensation structures that are linked to firm size (rather than the creation of shareholder value) or the desire to reduce their own employment risk choose to engage in transactions that do not necessarily maximize value from the standpoint of shareholders (Tosi & Gomez-Mejia, 1989; Wright et al., 2002a). Further, agency theory argues that divergence in the interests of shareholders and managers can be a function of their different attitudes toward risks. Shareholders are typically risk-neutral since they can easily diversify risk through their investment portfolio. In contrast, given their inability to diversify their firm related wealth, and also given human capital that is heavily invested in the firm, managers tend to be more risk-averse (Hill & Snell, 1989; Morck et al., 1990). They may also seek to diversify firm risk via the acquisition of unrelated businesses that may not necessarily represent positive net present value (NPV) projects (Datta & Puia, 1995; Doukas & Lang, 2003). Alternatively, they may choose to completely forgo foreign acquisitions which they

may deem to be inherently risky (Lee & Caves, 1998). Such actions are likely to be detrimental from the standpoint of external shareholders seeking value creation via projects that might entail greater risks but also have the potential of generating significant returns in the long-run.

In order to address agency problems resulting from conflict of interests and self-serving behavior on the part of managers, principals install governance mechanisms that help control management behavior via monitoring and incentives. These include having an independent board with a higher proportion of outside directors, limiting the tenures of members of the board, and curbing CEO influence by limiting position tenure, avoiding duality (wherein the top two positions are occupied by the same individual) and high levels of CEO equity ownership. In addition, greater ownership by active institutional shareholders should result in them more carefully monitoring management actions towards ensuring they create value.

Agency problems can also be mitigated by incentivizing top management to focus on long-term shareholder value creation. This includes providing them with greater equity ownership which help align their interests with the value-maximizing goals of shareholders. It follows that, in the context of foreign acquisitions, firms with strong corporate governance mechanisms are more likely to engage in acquisitions that improve shareholder value than those with relatively weak governance mechanisms. Since foreign acquisitions are associated with significant risks and information asymmetry, using agency-related arguments to explain the variance in acquisition-related performance among firms engaged in such transactions is particularly relevant (Carpenter, Sanders, & Gregersen, 2001).

While agency theory emphasizes the monitoring function of outside directors, resource dependence theory posits that outside directors can be very important sources of information in the identification of strategic alternatives and their selection (Pfeffer, 1972). In addition, they can add significant value by using their knowledge and expertise to provide counsel and guidance to firm management. Indeed, outside directors, who are often financial or legal experts, marketing specialists, government officials, or community leaders, are excellent sources of advice and

counsel given their knowledge, expertise and experience (Baysinger & Butler, 1985; Gales & Kesner, 1994). Outside directors also help provide the firm with key resources (e.g., financing, influence with regulatory bodies etc.). Indeed, organizations often recruit important directors from important stakeholder groups, such as capital investors, community advocates, key suppliers, and customers (D'Aveni, 1990). Mizuchi and Stearns (1994) and Stearns and Mizuchi (1993) have shown that having financial representatives as directors assists in the securing of financial backing for major projects.

The resource-dependency perspective that highlights the important role of interorganizational ties in the procurement of key resources (Pfeffer, 1972) overlaps with the social capital perspective that views directors as beneficial sources of knowledge and information via their linkages with or participation in other boards (Bourdieu, 1985). Social capital may be in the form of knowledge and information accessible through social networks (Burt, 1992). When directors are well-connected with other organizations in the focal firm's dynamic environment, information exchange and resource acquisition are facilitated as transaction costs are reduced (Hillman & Dalziel, 2003). As director ties encourage information dissemination across firms (Burt, 1980), strategic information and opportunities (Pfeffer, 1991) and operating plans of other firms (Burt, 1983) are revealed to the focal firm. Thus, individuals who serve on multiple boards are in a strong position influence strategy formulation and are often instrumental in determining subsequent firm performance (Eisenhardt & Shoonhoven, 1996). It has been shown that firms with directors who are connected to critical elements of the environment typically fared better than their industry peers whose directors lacked such ties (Pfeffer, 1972). Moreover, compared to directors with limited connections, those with extensive connections are in a better position to contribute to firm performance (Peng, 2004).

3.1.3. Contextual Variables: Firm and Environmental Factors

Transaction cost economics (TCE) posits that firms adopt governance forms (i.e., hierarchy, market, or a combination) that minimizes transaction and production costs

(Williamson, 1985). TCE has been widely used to explain foreign market entry mode choice (Anderson & Gatignon, 1986) but it may also be useful, particularly the concepts of transaction uncertainty, asset specificity, and frequency, in explaining how certain board governance mechanisms of cross-border acquiring firms contribute to value creation by aiding the reduction of transaction costs in specific environmental or organizational contexts where significant transaction costs exist.

TCE argues that in the face of high uncertainty, both internal and external, firms potentially face higher transaction costs (Williamson, 1979). External uncertainties are associated with volatile conditions in the host country (Hill & Kim, 1988) that makes it challenging for firms to predict future events (Milliken, 1987). Host countries that are marked by dynamism, such as high GDP growth or political risk, may be considered conditions with high external uncertainty. Under these conditions, a governance mechanism that helps deal with such dynamism, i.e., bigger boards with reputable directors who can draw on their contacts or their own experiences for more information, can possibly reduce transaction costs and improve shareholder value.

Internal uncertainty, on the other hand, is likely to exist when firms have limited knowledge or experience of foreign markets (Zhao, Luo, & Suh, 2004), making it more costly for them to embark on foreign ventures. When firms lack knowledge about foreign markets, they are likely to be less enthusiastic about expanding abroad through acquisitions since implementation costs may be too high. Lack of knowledge about the target's culture, in relation to the acquiring firm's own national culture, also represents an internal uncertainty. This can exacerbate problems associated with information asymmetry- especially when the firm has a strong, entrenched culture. This results in enhanced transaction costs. Board members who have been exposed to this different culture may be in a better position to more easily identify the implications of such differences for the firm, thereby reducing transaction costs.

Asset specificity relates to the resources that a firm invests in that contribute to its uniqueness and enhances its value in a particular transaction (Williamson, 1996). For example, the knowledge gained by firms in the context of prior cross-border acquisitions or by virtue of it having a presence in foreign markets, including, the host market can be leveraged and applied in the formulation and implementation of cross-border acquisitions. Doing so should result in superior performance and enhance acquisition related returns

Thus, I argue that a stronger governance structure may decrease the firm's transaction costs and thereby maximize shareholder value in situations where the external and internal uncertainty facing the acquiring firm is greater. Based on the above discussion, the research model for this study test is depicted in Figure 3.1.

3.2 Hypothesis: Long-term Shareholder Value

Efficiency-based theories have been used to explain why firms that expand beyond their national borders can create shareholder value in the long-run. Departing from neoclassical assumptions of perfect competition as a starting point, foreign direct investment theories indicate that firms are motivated to invest abroad because of imperfections in the capital, factor, and product markets (Caves, 1971; Hymer, 1976; Kindleberger, 1969). Using market-based rationale, internalization theory asserts that firms exploit these host market imperfections by deploying their intangible assets. In other words, internalization of intangible assets allows firms to reduce transaction costs arising from market imperfections in order to enhance their profitability and market values. Intangible assets include, but are not limited to, superior management and marketing skills, patent-protected technologies, product differentiation, and economies of scale while host market imperfections may include trade barriers, segmented

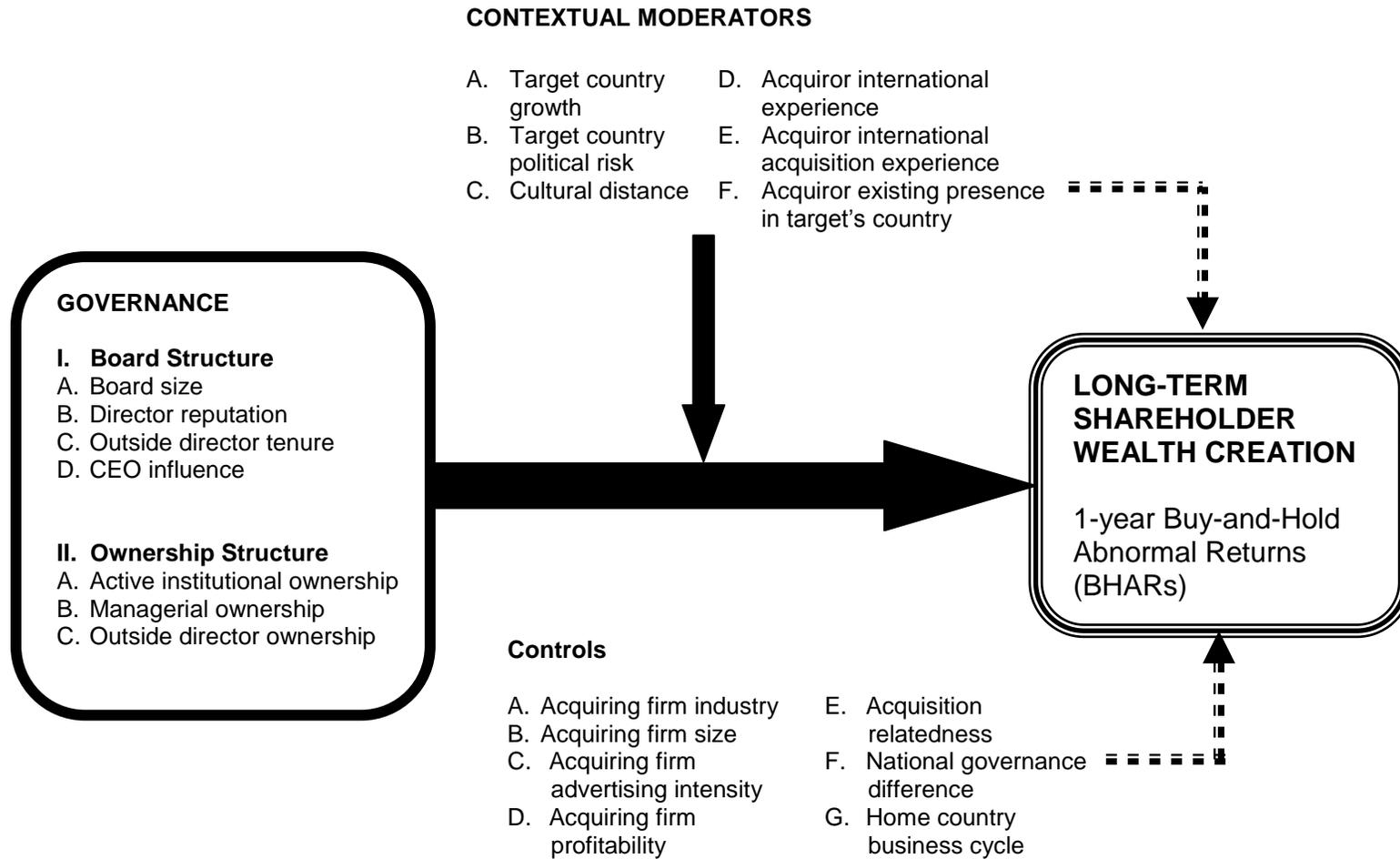


Figure 3.1 Research Model

capital markets, and mispriced factors of production from natural (e.g., factor endowment) or artificial (e.g., technology) causes.

In a similar vein, synergy hypothesis states that acquisitions generate long-term shareholder wealth when the combined firm's value is greater than the sum of the values of the individual firms by virtue of asset-sharing between the acquirer and target (Seth, 1990). This view is derived from the concept of "productive opportunity growth" advocated by Penrose (1959) wherein firms enhance profitability by seeking new markets that enable them to realize efficiencies and growth involving specialized assets without having to accept lower marginal revenues. Expanding into foreign markets by acquiring related businesses can become a source of firm value given associated scale and scope efficiencies. While in the past, the emphasis has been on "push" wherein, target firms benefit from the competencies and resources (e.g., technology and management practices) of the bidding firm. Recently, there is an increased focus on "pull" -- with the target's intangible assets being viewed as an important source of gains in the context of cross-border acquisitions. In "backward internalization," firms acquire targets abroad that possess intangible assets so that they may internalize and appropriate the rent generated by these assets (Eun et al., 1996). Thus, acquirers seek targets with unique skills and resources that may be valuable to their home market and can deliver positive returns to their shareholders (Seth et al., 2002) in the long-run.

Resource-based and organizational learning views suggest that international acquisitions are sources of new capabilities, such as in "backward internalization," and opportunities to learn new knowledge (Barkema & Vermeulen, 1998; Madhok, 1997; Vermeulen & Barkema, 2001). Thus, value creation by the acquisitions is partly captured by organizations utilizing their resources to create new opportunities (Penrose, 1959; Porter, 1979). Through "backward internalization," acquisitions provide access to new skill sets (e.g., Karim & Mitchell, 2000) that can also complement or reinforce existing skills, a source of competitive advantage generating positive shareholder value.

Based on the above arguments, I posit that cross-border acquisitions will create shareholder wealth from the standpoint of bidding firms in the long-run. Thus:

Hypothesis 1: Cross-border acquisitions will lead to significant shareholder value creation for bidding firms.

3.3 Hypotheses: Firm Governance Mechanisms

3.3.1 Board Structure

Boards represent an important aspect of the governance mechanism that serve and protect shareholders' interests via the monitoring of managerial behavior (Fama & Jensen, 1983b). Key board characteristics that have been investigated in prior research and are a part of my research model include board size, outside director reputation, outside director tenure, inside director tenure, and CEO influence. The arguments underlying the relationships between these attributes and shareholder value creation in the context of cross-border acquisitions are detailed in the following paragraphs.

3.3.1.1 Board Size

Firms that acquire foreign firms are likely to face greater complexities (Doukas & Pantzalis, 2003) which may arise from having to integrate resources within an environment characterized by cultural, institutional, and competitive differences (Gomez-Mejia & Palich, 1997). There are several reasons why larger boards can result in better market performance for firms seeking to internationalize through acquisitions. First, consistent with the resource dependence theory, larger boards can provide the firm with greater access to outside resources that are critical to firm success (Pfeffer & Salancik, 1978). As one former CEO who had been a member on several boards put it, 'more CEOs are viewing their boards as resources. They are not only comfortable but anxious to bring questions to the boards for 'which they don't have the answers' (Byrne & Melcher, 1996: 83). Directors represent critical channels of communication and their exposure to multiple industries and markets can help firms address the organizational challenges related to internationalization (Musteen, Datta, & Kemmerer, 2010; Sullivan, 1990).

They can reduce competitive “blind spots,” boosting firm competitiveness. Larger boards also have greater access to resources and expertise through the network connections of their directors (Rhee & Lee, 2008). These include interlocks which may provide access to other executives with experience in international acquisitions or in understanding potential targets and markets under consideration. This provides the firm with a diverse set of perspectives, knowledge, and experience to draw from, something that may not be readily available from corporate executives (Zahra, 1996). That, in turn, can result in value creating international acquisitions.

Second, larger boards with a bigger pool of skills and abilities possess superior information-processing capacity (Jackson, 1992). In addition, by bringing together a broader set of experiences, larger boards are in a position to generate meaningful dialogue and debate. When managers are required to consider, contest and evaluate a broader set of alternatives it ought to result in more thorough analysis of strategic alternatives and superior decision making (Forbes & Milliken, 1999). In the context of cross-border acquisitions we can expect larger boards should benefit acquiring firms in the identification and evaluation of potential candidates resulting in superior returns in the long-term.

Third, since there are more directors involved in the monitoring and evaluation of management actions, it can be meaningfully argued from an agency viewpoint that larger boards will lead to closer scrutiny and monitoring of top management decisions (Jensen, 1993). This is regardless of whether they are outside or inside directors, given that both insiders and outsiders have advantages when evaluating strategic decision made by the firm. Outside directors, given their relative independence, can be expected to maintain objectivity in their assessment of strategic decisions (Fama, 1980; Fama & Jensen, 1983b; Westphal, 1998), towards protecting the interests of shareholders. On the other hand, inside directors can bring their significant knowledge of the firm and its processes in the identification and evaluation of suitable acquisition candidates and subsequently determining the appropriate implementation

strategy for the acquisition. While the group dynamics literature (e.g., Hackman, 1990; Steiner, 1972) suggests that larger boards can be prone to problems associated with coalition building and maintaining effective communication and coordination (that often slows down the decision making process), there is extensive evidence (Dalton et al. 1999) that a systematic positive relationships between board size and firm performance exist.

The above arguments lead to the following hypothesis examined in my study:

Hypothesis 2: Board size will be positively associated with long-term shareholder value creation at bidding firms in cross-border acquisitions.

3.3.1.2 Outside Director Reputation

Outside directors are often invited to join the board of directors because of the favorable reputation they have built as successful managers (Fama and Jensen, 1983). Consistent with Fama and Jensen's (1983) argument, directors with a strong reputation to protect can be expected to be more vigilant in monitoring the actions of firm management. In other words, they are likely to be particularly concerned about actions that might jeopardize their own reputations since, favorable reputations helps them maintain their current board appointments and improves the opportunities for board positions at other prestigious organizations (Zajac & Westphal, 1996), In other words, directors with a strong reputation to protect can be expected to be extra-vigilant in monitoring managers so that they act in the interests of external shareholders in the making of key strategic decisions.

In addition to the above, directors with a strong reputation and an extensive network are in a position to provide the firm access to key resources (Pfeffer, 1972). Reputable directors, through director interlocks, can be valuable sources of contacts with key stakeholders and other constituents, including other director-managers with acquisition experience in similar settings (Walters et al., 2008). The knowledge they are bring via their network can help acquiring firms avoid mistakes and generate superior returns in their cross-border acquisitions. Such returns are often the outcome of board members with superior reputation being able to counsel firm

managers in their acquisition-related decision making and facilitate access to resources that are needed by the firm. Such directors are likely to be more effective in fulfilling their monitoring and counseling roles towards ensuring superior acquisition performance (Hillman & Dalziel, 2003). Moreover, individuals who are directors on multiple boards are likely to have greater influence in the formulation of acquisition strategies given their greater expertise from increased exposure to strategies in other organizations.

As observed by Lorsch and MacIver (1989) in addition to being directors at a number of firms, most outside directors are also CEOs in their own organizations. In the context of foreign acquisitions, it can be expected that directors who have built a reputation for being effective managers may be more effective in identifying acquisitions that likely to create shareholder value and detecting those where the primary driver might have been managerial interests. Their increased exposure to multiple firms as board members can also enhance their ability to efficiently process and evaluate conflicting information. Such abilities are particularly valuable in complex transactions such as cross-border acquisitions. Given their credibility vis-a-vis other officers and managers, outside directors with strong reputation are in a superior position to veto acquisitions which, in their belief, are not in the best interests of shareholders (Walters et al., 2008).

In the external market for directors, it is only natural that those with the strongest reputation are in great demand and receive the most offers for directorships. However, there is a downside to this reputation. It has been argued that directors, who have demanding full-time jobs and are members of several boards, are likely to be too busy to devote sufficient time and effort to their monitoring and counseling role (Adams, Hermalin, & Weisbach, 2008). However, the study by Ferris, Jagannathan, and Pritchard (2003) indicates that there is no clear evidence that reputable outside directors, when compared to their less reputable counterparts, shirk their responsibilities as directors. This leads to my next hypothesis:

Hypothesis 3: The reputation of outside directors will be positively associated with shareholder value creation at bidding firms in cross-border acquisitions.

3.3.1.3 Outside Director Tenure

Vafeas (2003) posits that director tenure signifies greater commitment, competence, and experience and longer tenures provides the director with greater expertise regarding firm-specific knowledge and processes. That, in turn, makes a long-tenured outside director a more effective monitor and an important source of advice and counsel. Outsiders with high tenure are also more confident and competent, having performed their jobs effectively over time as protectors of shareholder interests (Salancik, 1977). Additionally, their camaraderie with management (that grows from years of serving on the board) may allow them greater access to firm-specific information that top managers are sometimes not always willing to share with outside directors who are tasked to monitor them. In fact, Rutherford and Buchholtz (2007), in their study, found that higher tenure levels among outsiders resulted in greater information exchange among board members. That, in turn, should lead to more effective monitoring and better counseling resulting in superior decisions in the making of cross-border acquisitions. On the other hand, long tenures among outside directors have been a source for concern among governance scholars since entrenchment and close relationships with firm management can render them ineffective in their monitoring role (Canavan, Jones, & Potter, 2004; Lipton & Lorsch, 1992). This argument is similar to Vafeas' (2003) management friendliness hypothesis which argues that when outside directors are co-opted by management, they are less likely to be effective monitors, thereby paving the way for strategic decisions (including cross-border acquisitions) that may not necessarily generate shareholder value. In addition, entrenched directors can exacerbate "groupthink" (Janis & Mann, 1977) when they, inadvertently, adopt the mentality of inside directors. In fact, boards with longer tenured outside directors are viewed as being less effective by governance agencies (Canavan et al., 2004). As a result, corporate governance watchdogs have lobbied for putting limits on the tenure of outside directors. And,

because of the increasing clamor for shorter outside director terms, it is possible that outside director tenures among large foreign acquiring firms will not extend long enough for entrenchment to set in.

In sum, based on the above arguments we suggest the following:

Hypothesis 4: Outside director tenure will have a positive impact on the long-term shareholder value at bidding firms in cross-border acquisitions.

3.3.1.4 CEO Influence

Consistent with agency theory arguments, it can be argued that the effectiveness board monitoring of firm management is only as good as the CEO's influence allows it to be (Hermalin & Weisbach, 1998). Being a multi-faceted construct, CEO influence has been measured using a combination of different factors. For one, CEO influence is related to the composition of the firm's board. While theoretically, stockholders are tasked with electing directors into the board, in practice, nominated directors are often "hand-picked" by the CEO (Shivdasani & Yermack, 1999). When a CEO is powerful and influential, he/she can be expected to prefer a board that is composed of more insiders who are less inclined to monitor the CEO or criticize his/her actions for fear of being reprimanded or, worse, fired (Judge & Zeithaml, 1992).

Other aspects of CEO influence relate to the notion of duality (a situation where a single individual occupies the top two positions in the company) and the position tenure of the CEO (CEO tenure). The view that a CEO who is also the board chairperson enhances CEO dominance and renders the board relatively ineffective is also consistent with the theory of managerial hegemony (Kosnik, 1987). Within this perspective, ineffective boards are seen as providing managers with the freedom to pursue strategies that serve their personal interests and welfare (Gomez-Mejia, 1994). Westphal and Zajac (1995), for example, found duality to be positively associated with dominance of board members who are socio-demographically similar to the current CEO, with such similarity engendering the board to support the CEO's objectives. An extended position tenure is possibly the most direct measure of the CEO's power over the

board (Vafeas, 2003), taking into consideration the fact that one of the board's main functions involves monitoring CEOs and, in some instances, replacing them should they believe that they been ineffective in the carrying out their fiduciary responsibilities.

Given the above arguments and the expected very important role of firm CEOs in decisions pertaining to the choice of cross-border acquisitions and their subsequent implementation, I expect acquisitions made by firms with powerful and influential CEOs will be less focused on value creation. Instead, less scrutiny will permit them to make acquisitions that further their own interests. Thus:

Hypothesis 5: CEO influence will be negatively associated with the long-term shareholder value at bidding firms in cross-border acquisitions.

3.3.2. Ownership Structure

The effects of equity ownership by three key groups of owners, namely, active institutional investors, outside directors, and inside directors, have been examined extensively in the governance literature. The implications of their ownership from the perspective of value creation in cross-border acquisitions are discussed in the following paragraphs. .

3.3.2.1 Active Institutional Ownership

Institutional ownership relates to the equity in a firm that is owned and managed by institutions. Institutional ownership in firms has grown significantly over the past two decades - with close to 60% of equity in U.S. firms held by institutions on average in 1995, up from only about 47% in 1987 (Useem, 1996). In addition, with the largest 100 "owners" holding 52% of all shares in U.S. firms, ownership by institutions exhibits a high level of concentration (Bogle, 2005). As major owners of firm equity, institutional investors are viewed as an increasingly important part of firm governance with important implications for firm strategies.

Institutional owners are considered "superior investors" as they possess greater resources than the average investor to gather market knowledge in their assessment of investment decisions (Kochhar & David, 1996). Since institutional owners typically invest their

considerable resources in better managed firms, institutional ownership is often viewed as an indicator of good management. Institutional owners further contribute to the performance of the firms that they have invested in by actively monitoring management and the decisions made by them (Kochhar & David, 1996). Given that institutional investors have a fiduciary obligation to maximize long-term value for their constituents, they are also motivated to closely monitor firm management to ensure that value creation goals are met (Alchian & Demsetz, 1972). In addition, institutional investors are more easily able to monitor firm strategies and investment decisions since they are in a position to assign dedicated resources to the monitoring task (Schnatterly, Shaw, & Jennings, 2008).

While institutional owners cannot directly participate in the management of the firm, their large ownership gives them considerable power towards influencing firm top management in a number of ways. With their significant voting rights, institutional owners can exercise their “voice” in a variety of ways – e.g., via proxy contests, shareholder amendments, and floor resolutions during shareholder meetings, and also through direct communication with management (Gillan & Starks, 2000; Smith, 1996). With significant voting rights, institutional shareholders have the power to sway management’s opinion to their side (Kochhar & David, 1996). Large owners can also discipline non-performing managers via the trading of their shares (Baysinger, Kosnik, & Turk, 1991) with , heavy institutional selling that results in a significant drop in firm’s market value having been associated with the firing of top executives (Parrino, Sias, & Starks, 2003). As such, if institutional owners perceive a cross-border acquisition to be a negative net present value (NPV) investment, then they may short their positions on the acquiring firm, deterring managers from continuing with the acquisition in question.

Distinguishing between transient, quasi-indexer, and dedicated institutional owners, Bushee (1998) argues that different investor orientations, whether long-term or short-term, have different effects on managerial investment behavior and subsequent firm performance. Bushee

(1998) defines transient owners as short-term oriented institutional investors with a diversified portfolio and high turnover who often trade their limited stock ownership based on myopic measures such as current earnings. Transient institutional owners are often represented by money managers who are under pressure to perform well within a short period (quarterly, annually) in order to be retained and rewarded (Hansen & Hill, 1991). This creates a “multiple agent” scenario where the institutional fund manager who acts as a principal to the firm is also an agent to the principals of the institution providing the funds being invested (Arthurs, et al., 2008); a “dual identity” arises that can potentially lead to conflicts of interests (Pratt & Foreman, 2000). Thus, the myopic investment behavior exhibited by transient owners creates incentives for managers to prefer strategic action which can positively affect firm value in the short-run.

In contrast to transient owners, two other groups of investors, identified by Bushee (1998) as dedicated and quasi-indexers, have longer-term orientations. Although both groups of investors are characterized by lower portfolio turnover and buy-and-hold strategies, dedicated investors hold large ownership within a concentrated portfolio of a few firms while the quasi-indexers hold small ownership within a diversified portfolio of numerous firms. Due to their substantial ownership and long-term orientation, dedicated institutional investors are more motivated to actively monitor managers at firms they have invested in and gauge their performance on other benchmarks other than current earnings (Porter, 1992). As for quasi-indexers, their commitment to long-term indexing strategies (which involves buying balanced weightings of shares in a specific class of firms) provide incentives to monitor managerial strategic activity and ensure that their long-term interests are protected (Monks & Minow, 1995). This argument may be extended to cross-border acquisitions, where the active monitoring of dedicated and quasi-indexer owners should result in a more judicious choice of foreign target and possibly a more conscientious implementation of the same. Hence, when it comes to long-term shareholder wealth creation by acquiring firms, I posit that:

Hypothesis 6: Ownership by quasi-indexer and dedicated investor institutions, or active institutional owners, will be positively associated with long-term shareholder value at bidding firms in cross-border acquisitions.

3.3.2.2 Outside Director Ownership

Outside directors have traditionally been compensated for their services through a fixed annual retainer and a smaller fee for attending meetings. Unlike managers who receive incentive pay for superior performance, outside directors are typically not compensated based on firm performance. However, since the late 1980s, firms have been more active in using equity based compensation (either restricted stock or stock options), to remunerate directors. Researchers (e.g., Perry, 2000; Linn & Park, 2003) attest to the increasing popularity of this practice. Huson, Parrino, and Starks (2001), quoting the results of a Conference Board survey, also note a substantial increase in the use of incentive compensation for outside directors with 84% of firms surveyed in 1997 indicating their use of stock-based compensation for outside directors, from only 14% in 1989.

With this set-up, it appears that firms are trying to compensate directors based on firm performance. It is the subsequent appreciation in their value, not the fixed retainer, that motivates directors to take their monitoring responsibilities more seriously (Yermack, 2004). From an agency perspective, ownership by outside directors further reduces agency costs resulting from divergence in shareholder and managerial goals (Jensen, 1993). Given implications from the standpoint of their personal wealth, equity ownership is likely to motivate outside directors to increase their firm-specific knowledge and engage in more active monitoring of strategic decisions (Johnson, Hoskisson, & Hitt, 1993). As shareholders themselves, they can also be expected to advocate investment strategies are in the best interests of shareholders. Moreover, consistent with Hambrick and Jackson's (2000) view, outside directors with a personal stake in the firm are likely to be more proactive in the exploitation of their

network resources or more determined to extract inside information from managers to facilitate the undertaking of value creating foreign acquisitions. Thus:

Hypothesis 7: Outside director ownership will be positively associated with long-term shareholder value at bidding firms in cross-border acquisitions.

3.3.2.3 Inside Director Ownership

From a traditional agency perspective, inside director ownership has been argued to have a positive effect on long-term bidder shareholder value. This is because when managers are simultaneously important shareholders of the firm, agency problems stemming from misaligned goals and risk preferences between managers and shareholders are likely to be mitigated (Jensen & Meckling, 1976). Ownership transfers some of the risk-bearing from shareholders to managers by increasing the cost of forgoing value-enhancing investments that maximize long-term firm value (Wright, Kroll, Krug, & Pettus, 2007). The effectiveness of this alignment is based on the upside potential of equity ownership as managers stand to benefit from future growth and profitability that enhances the long-term value of their equity holdings. Ownership also means that they bear the costs associated with suboptimal decisions (Jensen & Murphy, 1990). The underlying premise behind equity ownership by managers is that such ownership imposes market discipline on managers and motivates them to engage in judicious risk taking, as in the case of foreign acquisitions.

Later scholars, however, contend that for managerial ownership to matter, it must be substantial. When managers have very limited equity ownership, engaging in acquisitions that do not maximize shareholder value may represent a desirable choice if personal employment benefits exceed the personal wealth loss (Agrawal & Mandelker, 1987). On the other hand, at extremely high levels, managerial ownership is less effective in curbing managerialism since it leads to entrenchment issues. Entrenched managers, with their large ownership may feel protected from the external market for corporate control (e.g. takeovers and proxy challenges), often used to regulate their behavior (Demsetz, 1983; Stulz, 1988). Additionally, managers

become more risk averse, especially if their ownership in the firm represents a large portion of their personal wealth. Because their financial wealth is dependent on the value of the equity they own in the firm, managers can be expected to act in a manner that minimizes downside risks (losses resulting from a drop in share prices) through more conservative, low risk strategies. This prediction is also consistent with the tenets of prospect theory (Kahneman & Tversky, 1979) which postulates that managers faced with potential losses can be expected to avoid high risk investments. As such, managers whose overall personal wealth is closely tied to firm equity prices can be expected to act in a risk-averse manner and choose low risk transactions that do not jeopardize their personal wealth and control. As such, cross-border acquisitions, which entail higher risks while having significant potential for value creation, may not be necessarily favored by such managers.

I hypothesize a positive relationship in the context of cross-border acquisitions considering firms that engage in cross-border acquisitions are more likely to be larger than domestic acquisitions (Moeller & Schlingemann, 2003). As such, the insider ownership is likely to constitute a small percentage of total outstanding shares and the limited ownership levels may not reach the levels that prompt risk-averse behavior among insiders.

Overall, I argue that managers with significant equity position in the firm may be enticed to engage in riskier, long-term oriented strategies such as foreign acquisitions. More importantly, managers will be more cognizant of the wealth effects of the acquisitions and their ownership exposure will prevent them from engaging in transactions that reduce shareholder wealth (Lewellen, Loderer, & Rosenfeld, 1985). They will be careful in limiting themselves to acquisitions which represent positive net present value investments and ensuring that the acquisitions they undertake create shareholder wealth. In other words:

Hypothesis 8: Inside director ownership will be positively associated with long-term shareholder value at bidding firms in cross-border acquisitions.

3.4 Hypotheses: Contingency Effects of Firm and Environmental Factors

Transaction cost economics (TCE) have similar foundations as agency theory, with both theories basing actor behavior on information asymmetry and opportunism. In TCE, the goal is to minimize monitoring and governance costs stemming from asset specificity, uncertainty, and frequency (Williamson, 1979; 1985). The concept of uncertainty, both internal (firm) and external (environmental), may help explain how governance mechanisms, particularly board structure, enable firms create more shareholder value in foreign acquisitions by minimizing transaction costs.

3.4.1 Target Country Growth, Political Risk, and Cultural Distance

High levels of target country growth and political risk are considered sources of external uncertainty for a firm entering a foreign market (Hill & Kim, 1998), including those that choose the acquisition route. In rapidly growing economies, markets tend to be more dynamic and competition less intense. In addition, they offer incumbents the opportunity to pursue a wide range of competitive behaviors. To deal with uncertainty associated with rapidly growing markets, firms need to gather greater amounts of information and process the same quickly if want to capitalize on the opportunities provided by market growth. Likewise, the acquisition of a firm in a country characterized by high political risk may also benefit from governance structures that help mitigate the potential challenges associated with such risk (Delios & Henisz, 2003). To respond quickly to political changes and exploit resultant opportunities, firm management must be well-informed and well-connected with key players in the host country political environment. By utilizing the knowledge base of their directors along with their network connections, firms can reduce the costs associated with the gathering and processing of necessary information. This decrease in transaction costs can translate to greater shareholder wealth generated from the acquisition. For example, firms with a larger board are more likely to have directors with direct experience of what it takes to operate successfully in a dynamic, fast growth market. They are more likely to be aware of host market needs and how the firm's existing capabilities can be

leveraged to fill market needs. In addition, larger boards can help create value in cross-border acquisitions undertaken in high growth markets because a larger board allows firm management to draw on the broader set of expertise associated with both the evaluation and implementation of their acquisitions. The outcome ought to be higher returns from the perspective of acquiring firms. Further, when directors have a high reputation and are affiliated with other firms as outside members of the board, the network resources they offer to the firm can be particularly invaluable in the identification of value creating acquisitions in foreign markets. In other words, directors with strong personal reputation and extensive networks are likely to be more effective in assisting firms with their acquisitions in high growth markets.

Outside directors with longer tenures (i.e., those who have served on the firm's board for an extended period), can combine their industry and market knowledge with their knowledge of firm operations (gleaned from their own observations or from inside managers with whom they have developed camaraderie over the years) to identify potentially attractive targets in foreign markets. In addition, their knowledge can be particularly valuable in ensuring that mistakes are avoided both in the negotiation and the implementation phases. They are likely to be well suited to guide firm top management in their acquisition efforts in dynamic, high growth markets. In such markets, firms are often expected to react swiftly to take advantage of opportunities from environmental shifts. Knowledge on how these opportunities can be best exploited can come from outside directors with significant experience.

Agency theory arguments suggest that when firms have CEOs with considerable power and influence the effects can be negative from a value creation perspective (the entrenchment argument). An entrenched and influential CEO often requires higher levels of monitoring and this can detract outside directors from pursuing their other responsibilities, including providing advice and counsel to managers in their pursuance of cross-border acquisitions.

The contingency effects of host country market growth on the relationships between governance structures and long-term acquisition performance is summarized in the form of the following hypotheses:

Hypothesis 9a: Board size will have a stronger positive relationship with firm shareholder value creation in cross-border acquisitions when such acquisitions are undertaken in a country with a high rather than a low market growth.

Hypothesis 9b: Director reputation will have a stronger positive relationship with shareholder value creation in cross-border acquisitions when such acquisitions are undertaken in a country with a high rather than a low market growth.

Hypothesis 9c: Outside director tenure will have a stronger positive relationship with shareholder value creation in cross-border acquisitions when such acquisitions are undertaken in a country with a high rather than a low market growth.

Hypothesis 9d: CEO influence will have a stronger negative relationship with firm shareholder value creation in cross-border acquisitions when such acquisitions are undertaken in a country with a high rather than a low market growth

And with respect to the target country's political risk, I expect that:

Hypothesis 10a: Board size will have a stronger positive relationship with bidding firm shareholder value in cross-border acquisitions when such acquisitions are undertaken in a country with a high rather than a low political risk.

Hypothesis 10b: Director reputation will have a stronger positive relationship with bidding firm shareholder value in cross-border acquisitions when such acquisitions are undertaken in a country with a high rather than a low political risk.

Hypothesis 10c: Outside director tenure will have a stronger positive relationship with bidding firm shareholder value in cross-border acquisitions when such acquisitions are undertaken in a country with a high rather than a low political risk.

Hypothesis 10d: CEO influence will have a stronger negative relationship with bidding firm shareholder value in cross-border acquisitions when such acquisitions are undertaken in a country with a high rather than a low political risk.

Lack of similarity with the target's culture, in relation to the firm's own, on the other hand, represents an internal uncertainty as it relates to a firm's limited knowledge of foreign market conditions and culture (Zhao, Luo, & Suh, 2004). Problems related to information asymmetry can be worse when the host culture has a long, complex history. The outcome is often enhanced monitoring and information gathering costs, contributing to reduced returns in cross-border acquisitions. Lower cultural distance, i.e., the difference between the country cultures of the acquiring and acquired firms (Kogut & Singh, 1988), can contribute to improved efficiency on the part of the acquiror in their efforts at leveraging firm-specific resources, in the acquired firm environment.

When firms have a larger board, there is a greater likelihood that some on the board will have the expertise or experience required to deal with the cultural systems in the host country. With the help of directors who possess knowledge of the host country culture, an acquiring firm can avoid some of the costs associated with the liability of foreignness (Zaheer, 1995) and double acculturation (Barkema & Vermeulen, 1998).

Reputable directors, with their wider, possibly, international, networks and exposure, are more likely to have access to executives who have the knowledge on how to operate effectively in culturally distant countries and, at times, weaker investor protection regimes. As such, they represent excellent resources for best practices that can reduce transaction cost and increase shareholder value. An influential CEO will further exacerbate agency problems encountered in countries with weaker governance, driving transaction costs up and depleting shareholder wealth.

In sum, the relationships between governance structures and long-term acquisition returns for bidding firms are likely to be contingent on cultural differences. The specific hypotheses examined in my study are as follows:

Hypothesis 11a: Board size will have a stronger positive relationship with bidding firm shareholder value in cross-border acquisitions when such acquisitions are undertaken in a country with a distant rather than a proximate national culture.

Hypothesis 11b: Director will have a stronger positive relationship with bidding firm shareholder value in cross-border acquisitions when such acquisitions are undertaken in a country with a distant rather than a proximate national culture.

Hypothesis 11c: Outside director tenure will have a stronger positive relationship with bidding firm shareholder value in cross-border acquisitions when such acquisitions are undertaken in a country with a distant rather than a proximate national culture.

Hypothesis 11d: CEO influence will have a stronger negative relationship with bidding firm shareholder value in cross-border acquisitions when such acquisitions are undertaken in a country with a distant rather than a proximate national culture.

3.4.2 Acquiring Firm International Experience, Cross-Border Acquisition Experience, and Existing Presence in the Target Firm Country

Given asset specificity and the uniqueness of some assets to a particular transaction or situation it becomes difficult for firms to deploy such assets in the creation of value in certain contexts (Williamson, 1975). Unique assets relate to organizational knowledge garnered from prior acquisitions, presence in multiple international markets, and from existing operations in the target firm country. The key to gaining more value out of specific assets is to deploy them more frequently in similar situations (Williamson, 1979). A larger board, for instance, is more likely to have directors who are familiar with opportunities in countries where the firm already has a presence. This knowledge enables the firm to more effectively exploit its knowledge-based asset. Additionally, when outside directors have longer tenures and are characterized by

superior reputation they can be expected to be more vigilant when the firm seeks to engage in cross-border transactions that utilize resources that are outside the scope of the firm. Finally, consistent with agency precepts, influential CEOs, on the other hand, may prefer to diversify the firm's knowledge base and acquire new experiences, i.e., through acquisitions in target countries where firm does not have a presence. Given the resultant high learning costs following the transaction, an acquisition can result in reduced shareholder wealth. The specific hypotheses on the contingency effects of acquisition experience, international experience and existing presence in the foreign country on the governance-acquisition returns relationship is presented below:

Hypothesis 12a: Board size will have a stronger positive relationship with bidding firm shareholder value in cross-border acquisitions when such acquisitions are undertaken by firms with more than less acquisition experience.

Hypothesis 12b: Director reputation will have a stronger positive relationship with bidding firm shareholder value in cross-border acquisitions when such acquisitions are undertaken by firms with more than less acquisition experience.

Hypothesis 12c: Outside director tenure will have a stronger positive relationship with bidding firm shareholder value in cross-border acquisitions when such acquisitions are undertaken by firms with more than less acquisition experience.

Hypothesis 12d: CEO influence will have a stronger negative relationship with bidding firm shareholder value in cross-border acquisitions when such acquisitions are undertaken by firms with less than more acquisition experience.

And with respect to the acquiring firm's past international acquisition experience, I hypothesize that:

Hypothesis 13a: Board size will have a stronger positive relationship with bidding firm shareholder value in cross-border acquisitions when such acquisitions are undertaken by firms with more than less international experience.

Hypothesis 13b: Director reputation will have a stronger positive relationship with bidding firm shareholder value in cross-border acquisitions when such acquisitions are undertaken by firms with more than less international experience.

Hypothesis 13c: Outside director tenure will have a stronger positive relationship with bidding firm shareholder value in cross-border acquisitions when such acquisitions are undertaken by firms with more than less international experience.

Hypothesis 13d: CEO influence will have a stronger negative relationship with bidding firm shareholder value in cross-border acquisitions when such acquisitions are undertaken by firms with less than more international experience.

Below are my hypotheses with regard to the acquiring firm's presence in the target country:

Hypothesis 14a: Board size will have a stronger positive relationship with bidding firm shareholder value in cross-border acquisitions when such acquisitions are undertaken by firms with an existing than non-existing presence in the target country.

Hypothesis 14b: Director reputation will have a stronger positive relationship with bidding firm shareholder value in cross-border acquisitions when such acquisitions are undertaken by firms with an existing than non-existing presence in the target country.

Hypothesis 14c: Outside director tenure will have a stronger positive relationship with bidding firm shareholder value in cross-border acquisitions when such acquisitions are undertaken by firms with an existing than non-existing presence in the target country.

Hypothesis 14d: CEO influence will have a stronger negative relationship with bidding firm shareholder value in cross-border acquisitions when such acquisitions are undertaken by firms with a non-existing than existing presence in the target country.

CHAPTER 4
METHODOLOGY

4.1 Sample

My starting sample consisted of all cross-border acquisitions completed between January 1990 and December 2006 as reported in Thompson Financial's SDC Platinum database. This database, which has been extensively used by researchers engaged in the study of mergers and acquisitions, provides a comprehensive listing of all cross-border transactions. My study was confined to pre-2007 transactions to enable the examination of post-acquisition returns over longer time horizons (one-year and two-year periods). In addition, the study was limited to transactions where bidding firm was from the U.S. with the target being identified as "foreign." For the purposes of this study, only acquisitions that provided the U.S. acquiror with a controlling stake in the target firm was considered. In other words, I excluded all partial acquisitions involving less than a 51% stake. In addition, only transactions valued in excess of \$100 million and where the transaction value was at least 5% of the acquirer's asset value were included in the final sample. This allowed me to limit the study to major acquisitions (in absolute and relative terms) from the standpoint of bidding firms and which can be expected to have an important impact of shareholder value. Data availability on all study variables resulted in a final sample of 453 acquisitions. The number of foreign countries associated with the target firms in my sample was 42. The yearwise break of the acquisitions in the sample, by geographic region, is provided in Table 4.1.

Table 4.1 Sample Acquisitions Broken Down by Year and Target Country Region

Year	Africa	Asia and Australia	Europe	North America	South and Central America	Total
1991			4	1		5
1992		4	9	2		15
1993			6	3	1	10
1994		1	11	3	1	16
1995		3	15	5	1	24
1996			19	5	2	26
1997		8	25	9		42
1998		4	29	7	2	42
1999	4	1	24	5	3	37
2000	1	6	29	11	1	48
2001			21	11	1	33
2002		2	15	3	1	21
2003		3	14	6		23
2004	1	4	27	8	1	41
2005		6	20	9	1	36
2006	2	6	20	5	1	34
Total	8	48	288	93	16	453

4.2 Data Analysis

In this study, I assessed long-term shareholder wealth effects using the buy-and-hold abnormal returns (BHARs). Given the cross-sectional nature of my study, the use of the BHAR methodology was viewed as being more appropriate than a time-series methodology such as CTAR (Boubakri, et al., 2009). The strength of the BHAR approach lies in its ability “to yield an abnormal return measure that accurately represents investor experience” (Lyon et al., 1999: 198). To address the weaknesses in the BHAR methodology, several remedies suggested in the literature were adopted. Long-term performance of the sample firm were compared to benchmark portfolios developed based on key factors such as firm size based on market capitalization and market-to-book ratio. This enabled me to control for sources of misspecification such as new listing bias and rebalancing bias in long-term market performance studies (e.g., Barber & Lyon, 1997; Kothari & Warner, 1997). Following Lyon et al. (1999), I used bootstrapped skewness-adjusted t-statistic (to control for the skewness bias) to assess the significance of BHARs in my study. One of the primary weaknesses of the BHAR methodology

in the assessment of returns over a longer time horizon relates cross-sectional data dependence brought about by overlapping acquisitions made by sample firms within the time frame over which BHARs were computed (Fama, 1998; Mitchell & Stafford, 2000). To address this issue, cases where there were overlapping returns within the observation period were eliminated. This is consistent with the recommendations of Lyon et al., (1999) and the approach used by Doukas and Lang (2003) in their study of acquisitions.

To test my hypotheses on the direct effects of governance variables on long-term abnormal return, I utilized OLS regression analysis with robust clusters. OLS regression assumes that the residuals are independent. However, the 453 acquisitions in my sample were made up by 394 firms. In other words, there were some instances where a particular firm was involved in more than one acquisition over the fifteen year time horizon of my study. It is possible that the returns within each firm may not be independent, and this could lead to residuals that are not independent within firms. To address the potential problems from biased standard errors, I used the cluster option in the regression model (in STATA 11) to generate clusters of acquisition transactions based on the acquiring (using the unique firm number provided in Compustat). While these clusters of acquisition observations may be correlated within firms, they would be independent between firms. This approach estimates the model by OLS but uses the Huber-White/sandwich (robust) estimates of variance (and thus standard errors). These variance estimates are robust to any type of correlation within the observations of each firm. To test the contingency effects of key environmental and organizational factors on the relationship between the governance factors and long-term abnormal return, I used moderated regression analysis, the desired methodology in the testing of interaction effects (Aguinis, 1995).

4.3 Dependent Variable: 1-year Buy-and Hold Abnormal Returns (BHARs)

The buy-and-hold return (BHR), or the total returns from a buy-and-hold strategy, of the acquiring firm's stock is computed from the month of the completion date of the acquisition to 1

year thereafter. This BHR is then referenced against a benchmark BHR – representing a control portfolio of firms that are similar to the acquiring firm in terms of market capitalization, book-to-market ratio, and previous performance, to compute the buy-and-hold abnormal return (BHAR) associated with the acquisition. In other words, BHARs capture differences in market returns across firms that engage in foreign acquisition relative to a benchmark portfolio.

Black et al. (2007) identify the three steps involved in the computation of the long-term BHAR for a specific firm: 1) benchmark portfolio generation, 2) matching firm to benchmark portfolio, and 3) buy-and-hold difference (BHAR) computation. The benchmark portfolio was constructed as follows:

First, firm-size reference portfolios were formed by ranking all NYSE firms in deciles based on the market capitalization in the completion month of the acquisition; the smallest decile was further divided into quintiles. With the breakpoints for each portfolio, AMEX and NASDAQ firms were assigned into one of the 14 portfolios. Next, each of the 14 size-based portfolios was divided into quintiles based on the book-to-market ratios in the month of the acquisition. This resulted in a total of 70 portfolios. Finally, for each of the 70 portfolios, 3 reference portfolios, based on the previous performance measured with the last 12-month buy-and-hold returns, were constructed. That brought the total number of portfolios to 210. Following that, each acquiring firm was matched to one of the 210 portfolios that best fits its size, book-to-market ratio, and past performance during the completion month.

The BHR for the portfolio was computed by first compounding the returns on the securities within the portfolio and then summing across the securities using the formula:

$$R_{pst}^{bh} = \sum_{i=1}^{n_s} \frac{[\prod_{t=s}^{s+\tau} (1 + R_{it})] - 1}{n_s}$$

where R_{it} is the return on security i in month t , τ is the period of investment in months, and n_s is the number of securities traded in month s , the beginning period for the return calculation. The sample firm's BHR was then computed by the compounded return for the period of investment in months:

$$R_{it}^{bh} = \sum_{i=1}^{\tau} \left[\prod_{t=s}^{s+\tau} (1 + R_{it}) \right] - 1$$

Finally, the difference between the BHR of the acquiring firm from the sample and that of the equally weighted matched portfolio is computed to derive the BHAR. I compute the BHAR for +1 year post-acquisition period, starting with one month after the completion date.

$$AR_{it} = R_{it} - E(R_{pt})$$

Consistent with other long-term studies on bidder returns in foreign acquisition (e.g., Black et al., 2007; Chakrabarti, et al., 2009), completion dates, or effective dates (as they are referred to in the SDC database), were used (rather than announcement dates) given that my study emphasizes actual post-merger performance and not the “announcement related wealth effect.”

To test whether the computed BHAR was significantly different from zero, I used the bootstrapped skewness- adjusted t -statistic suggested by Lyon, et al. (1999). I calculated the bootstrapped t -statistic by drawing a random “resample” with size $n/4$ from the pool of sample firms. This process was repeated 1,000 times to come up with an empirical distribution of long-term abnormal returns, including the bootstrapped skewness-adjusted t -statistic. The statistical significance of the mean abnormal returns for the sample firms was determined using the

following. If the sample mean abnormal return is positive (negative), I counted the resample portfolio abnormal returns that are greater (less) than the sample mean abnormal return. I then divided this number by 1,000 (the number of resample portfolios), generating the p -value of the sample mean abnormal return.

4.4 Measures: Independent Variables

Study variables were operationalized as follows:

4.4.1 Board Structure

4.4.1.1 Board size

Consistent with other studies in the governance literature (e.g., Coles et al., 2007; Sanders & Carpenter, 1998), board size was measured as the total number of directors on the firm board.

4.4.1.2 Director reputation

Based on the approach used in prior research (e.g., Fich & Shivdasani, 2005; Kor & Sundaramurthy, 2009; Vafeas, 2003), I assessed director reputation using the number of outside directorships held by the director (aside from being a director in the focal firm). As argued by Kor and Sundaramurthy (2009), the participation of directors in multiple boards exposes them to various strategic and governance issues that improve their abilities to effectively monitor the firms. Multiple directorships also allow directors to build a richer and more diverse network of resources which can result in better advice and counsel. Thus, the additional number of the outside directorships held represents the director's reputational capabilities to provide high quality advice and monitoring. In the external market for directors, the individual with more reputable track record for being an effective monitor receives more offers of outside directorships. To arrive at the average director reputation, I aggregated the total number of directorships for each of the directors on the board and calculated its mean.

4.4.1.3 Average outsider tenure

As is common in the literature (Vafeas, 2003), average outside director tenure was operationalized as the average tenure, in number of total years, of the firm's outside directors.

4.4.1.4 CEO influence

This is a composite measure of 3 items- board non-independence, duality, and CEO tenure that have been associated with CEO influence (Alam, Chen, Ciccotello, & Ryan, 2011; Boone, Field, Karpoff, & Raheja, 2007; Masulis & Mobbs, 2011; Sridharan, 1996). Board non-independence represents the ratio of non-independent directors (firm officers, former officers, and outside directors with family ties to officers or former officer) to the total number of board members (Fama & Jensen, 1983). Duality was measured as a dummy variable with 1 indicating duality (where both the board chair and CEO positions are held by the same individual) and 0 otherwise. CEO tenure was defined as the number of years the CEO had held the position with the focal firm at the time of the acquisition. To calculate the CEO influence, the scores for board non-independence, duality, and tenure were standardized, with a mean of 0 and standard deviation of 1. Based on the approach used widely in the literature (e.g., Datta, Rajagopalan & Zhang, 2003), these standardized scores were then averaged to yield the measure of CEO influence.

4.4.2. Ownership Structure

4.4.2.1 Active institutional ownership

Bushee (1998) classified institutional owners into three categories: transient owners, dedicated owners and quasi-indexers. Transient institutional owners are short-term oriented, characterized by high portfolio turnover and diversified portfolios. On the other hand, long-term oriented dedicated institution owners hold more concentrated portfolios with low turnover. Quasi-indexers, which, like transient owners, hold diversified portfolios, are long-term oriented with their low portfolio turnover. Following Bushee (1998), active institutional ownership was operationalized as the ratio of the total equity owned by institutions classified as quasi-indexers

and dedicated investors to total outstanding common stocks. Information on institutional ownership was collected from the 13(f) filings as compiled in the Thompson Institutional database.

4.4.2.2 Outside director ownership

Outside director ownership was measured by computing the percentage of total outstanding common stocks owned by outside directors on the board (Johnson et al., 1993; Vafeas, 2003).

4.4.2.3 Inside director ownership

As is customary in the literature (e.g., Datta, et al., 2009; Hoskisson et al., 2002; Morck & Yeung, 1992), inside director ownership was computed as the percentage of total outstanding common shares owned by insiders on the board of directors.

Data on the above independent variables (except when stated otherwise) were obtained from the Riskmetrics databases or from proxy statements (when it was not available in Riskmetrics). . As is common, the data was lagged by a year. In other words, data for all explanatory variables were collected for the fiscal year preceding the acquisition completion year.

4.5 Measures: Contingency Variables

Contextual factors, deemed to have contingency effects on the relationship between the firm governance and long-term shareholder value of the firm, were operationalized as follows:

4.5.1 Target Country GDP Growth

The target country's GDP growth is measured by taking the average of the country's GDP growth over the 3 years preceding the acquisition (Musteen, et. al, 2009). GDP growth has often been used in the international business literature as a proxy for the stage of host market development and market attractiveness. Data on GDP was collected from the World Bank database.

4.5.2 Target Country Political Risk

The political risk associated with the target firm country was measured using the overall score reported in the International Country Risk Guide created by the Political Risk Services (PRS) Group. Political risk has been used in previous studies as a measure of external uncertainty and has been shown to impact foreign investment decisions (Johnson & Tellis, 2008; Uhlenbruck, Rodriguez, Doh, & Eden, 2006). With higher values in the PRS database (reported on a scale of 0-100) reflective of low political risk, the measure was reverse coded by subtracting the value from 100. This measure has been used widely in recent international business literature (e.g., Chan & Makino, 2007; Click & Weiner, 2010).

4.5.3 Cultural Distance

Based on the procedure outlined in Kogut and Singh (1988) and Datta and Puia (1995), cultural distance was assessed using a Euclidian distance measure derived from the four dimensions identified by Hofstede. (1980). In other words, the composite measure of cultural distance was based on distances along the dimensions of masculinity, individualism, power distance, and uncertainty avoidance. This measure has been very widely used in the international business literature, including studies on the effects of cultural distance on the performance of cross-border acquisitions.

4.5.4 Acquiror Cross-Border Acquisition Experience

Acquiror acquisition experience was operationalized by counting the number of foreign acquisitions in the Thompson SDC database that the acquiring firm had made in the five years preceding the acquisition in question. This is similar to the measure that has been used recently by Kang and Kim (2010) in their study of post-acquisition governance activities undertaken by foreign acquiring firms.

4.5.5 Acquiror International Experience

International experience of the acquiring was defined as the ratio foreign sales to total sales of the firm. This measure has been widely used in the international business and strategy

literatures (Aulakh & Kotabe, 1997; Carpenter, Pollock, & Leary, 2003; Musteen et al., 2009).

The data for this measure was obtained from the Compustat database.

4.5.6 Acquiror Existing Presence in Target Country

This was operationalized as a dichotomous variable. When the acquiring firm had a presence in the country of the target firm at the time of the acquisition, it was coded as '1' (and 0 otherwise). A firm's presence in the target country is determined using the *Directory of U.S. Firms Operating in Foreign Countries*. However, this directory is not published annually; for this study, directories for the years 1987, 1991, 1994, 1996, 1999, 2001, 2003, and 2005 were consulted. Consistent with previous studies (e.g., Doukas, 1995; Doukas & Travlos, 1988), I used the most recent directory prior to the announcement year.

4.6 Measures: Control Variables

In addition to the independent and contingency variables, I controlled for several control variables. The operationalizations of these variables, which have been shown to impact acquisition performance, are described in the following paragraphs.

4.6.1 Acquiror Industry

Since my sample included both acquisitions in the manufacturing and the services sector, I used a dummy variable to distinguish between the two. The variable was assigned a value of '1' when the acquiring firm was from the manufacturing sector (2-digit SIC less than 40) and '0' when the acquiring firm was from the service sector (2-digit SIC greater than or equal to 40).

4.6.2 Acquiror Size

It can be argued that larger firms, given greater access to resources, are likely to be in a superior position to undertake the necessary due diligence that would increase the likelihood of success. I control for firm size of the firm using the natural logarithm of the number of employees, an operationalization that has been commonly used in the international business

and strategy literatures (e.g., Datta et al., 2009; Datta & Rajagopalan, 1998; Matta & Beamish, 2008).

4.6.3 Acquiror Profitability

The market's reaction to an acquisition may be colored by the perceived quality of the acquiring firm. A firm that has a record of above average profits is likely to be viewed as being a well-managed firm, capable of undertaking and implementing cross-border acquisitions effectively. In addition, firms characterized by high profits are more likely to have the resources required in the post-acquisition phase to make the merger "work". Accordingly, I controlled for acquiring firm profitability, measured as the average return on assets (ROA) in the 3-years prior to the acquisition (Musteen, et. al, 2009).

4.6.4 Acquiror Advertising Intensity

According to internalization theory, firms with intangible resources can derive greater value from foreign expansion by internalizing the market through full ownership modes such as acquisitions (Buckley & Casson, 1976). Indeed, prior research indicates that firm advertising intensity is associated with long-term bidder shareholder wealth creation (Gregory & McCorrison, 2005) and short-term announcement return (Markides & Ittner, 1994). Advertising intensity was measured at the firm-level in instances where firm level data was available. However, with data on advertising expenditures missing for a fairly large percentage of the firms in Compustat, I substituted industry advertising intensity averages (at the 3-digit level) as has been done by other researchers (e.g., Datta et al., 2009; Gregory & McCorrison, 2005).

4.6.5 Acquisition Relatedness

From a synergy hypothesis standpoint, cross-border acquisitions within related industries can result in operating efficiencies from sharing existing assets such as R&D facilities, and production, advertising and distribution capabilities and thereby generating more positive shareholder returns. Empirically, Doukas and Lang (2003) have shown that acquiring related foreign targets to be positively associated with firm shareholder value in the long-run.

Thus, the effect of relatedness on long-run acquisition performance must be taken into account. Because this study involved targets from foreign countries, a more detailed information on the target firm's primary lines of business as classified by the 4-digit SIC industries was not readily available, making it difficult to compute a more complex measure of relatedness, such as the one used by Halebian and Finkelstein (1999). Following the operationalization adopted by Rumelt (1982), relatedness was measured as a dichotomous variable based on the similarity between the acquiring and acquired firms at the 3-digit SIC level. An acquisition was deemed to be related if both the acquiring and acquired firm belonged to the same 3-digit SIC industry.

4.6.6 Governance Difference

When a host country has a lax shareholder protection regime, problems with information asymmetry in these conditions are worse because governance transparency is lacking (Leuz, Lins, & Warnock, 2010). This leads to more costly monitoring and information gathering that raises transaction and agency costs. And when an acquiring firm comes from a more stringent national governance system, such as the U.S., there is an opportunity for the acquiror to reduce the agency costs and raise shareholder value when the more transparent governance measures are applied to the target firm. To control for this effect, I include a variable that accounts for the difference in governance regimes between the target host country and the acquiror home country, the U.S. A measure of governance effectiveness in the host country is provided by the shareholder rights index that was initially compiled by La Porta et al. (1998) and updated by Djankov et al. (2008). Also called anti-director index, it counts the presence of the following six factors protecting minority investors: (1) vote by mail, (2) obstacles to the actual exercise of the right to vote (i.e., the requirement that shares be deposited before the shareholders' meeting); (3) minority representation on the board of directors through cumulative voting or proportional representation; (4) an oppressed minority mechanism to seek redress in case of expropriation; (5) preemptive rights to subscribe to new securities issued by the company; and (6) the right to call a special shareholder meeting. A score of 6 indicates a

strong shareholder protection culture. La Porta et al.'s (1998) index for the year 1993 was used in the context of acquisitions undertaken between 1990 and 1997. Djankov et al.'s (2008) revised index for the year 2003 was used for acquisitions undertaken between 1998 and 2006. The governance difference was measured by subtracting the host country's shareholder rights index from that of the U.S. (which had a score of 5).

4.6.7 Home Country Economic Business Cycle

To take into account the different business cycles present during the entire sample time period, I introduced a dummy variable for the years 1991 and 2001, indicating declines in the economic business cycle based on the coincident composite index compiled by Economic Cycle Research Institute (ECRI), an index used by Layton (1998) to measure business cycles.⁶

A summary of the all variables, their operationalization and data sources is provided in Table 4.2.

Table 4.2 Summary of Variables and Their Data Sources

Variable	Operationalization	Data Source
Control variables:		
Acquiror industry	1=Manufacturing 0=Services	Thompson SDC, Compustat
Acquiror size	Ln(employees)	Compustat, proxies
Acquiror ROA	Average ROA 3 years pre-acquisition	Compustat
Acquiror advertising intensity	Advertising expense/sales	Compustat
Acquisition relatedness	1=Related acquisition (same 3-digit SIC) 0-Unrelated acquisitions	Thompson SDC
Governance difference	Difference in shareholder protection index between U.S. and target host country	La Porta, et al. (1998); Djankov, et al. (2008)
Home country business cycle	1=1991, 2001	Economic Cycle Research Institute (ECRI)

⁶ An alternative measure using ECRI's data on the declines in growth rates for the years 1995, 1998 to 1999, 2001, 2003, and 2005 also yielded similar results.

Table 4.2 – *Continued*

Contingency:		
Host country GDP growth	GDP growth in the 3 years preceding the acquisition	World Bank database
Host country political risk	Political risk index (reverse-coded)	PRS
Cultural distance	Cultural distance between the acquiring and acquired firm countries	Hofstede (2001)
Acquiror acquisition experience	Number of foreign acquisitions completed in the past 5 years	Thompson SDC
Acquiror international experience	Foreign sales/total sales	Compustat
Acquiror presence	1=Acquiror has existing presence in target host country	Directory of U.S. Firms Operating in Foreign Countries
Independent variables:		
Board size	Acquiror board size	RiskMetrics, proxies
Director reputation	Average number of outside directorships held by members of the acquiring firm's board	RiskMetrics, D&B Reference Book of Corporate Management, proxies
Outsider tenure	Average board tenure of outside directors (in years) at the acquiring firm	RiskMetrics, proxies
CEO influence	Composite index based on the average of the standardized scores of board non-independence, duality, and CEO tenure	RiskMetrics, proxies
Active institutional ownership	Total ownership by quasi-indexers and dedicated institutional shareholders	Thompson 13f database, Bushee (1998)
Outsider ownership	Total outsider director ownership	RiskMetrics, proxies
Insider ownership	Total insider director ownership	RiskMetrics, proxies

CHAPTER 5

RESULTS

5.1 Descriptive Statistics

The means, standard deviations, and zero-order correlations of study variables are provided on Table 5.1. The mean board size for sample firms was nine. While this figure is somewhat lower than in studies by Yermack (1996) Bhagat and Black (2001), it is in line with the mean board size in the study by Ben-Amar and Andre (2006). The average tenure for outside directors was 6.58 years. Vafeas (2003), in his study, found that average member tenure of board to be 9 years. With regards to the measures included in the CEO influence index, the mean position tenure of CEOs was 7.8 years, the average ratio of inside directors was 38.2% and the percentage of firms with duality was 68.9%. These numbers are similar to other studies. Boubakri et al. (2008) found that the average CEO tenure was 9.2 years with 57.6% of their sample insurance firms being characterized by duality. Meanwhile, Wright et al. (2002a) observed an average CEO tenure of 6 years for their sample of U.S. domestic acquiring firms between 1993 and 1998. Yermack (1996), on the other hand, observed an inside director ratio of 36% over the period 1984-1991.

Active institutional owners held, on average, 44% of firms' total outstanding shares. Chen et al. (2007), in their study found an increasing trend in institutional ownership from 1982 to 2001, with institutional shareholders accounting for 52% ownership in 2001. Finally, the outside director ownership was 1% and the mean ownership by insider directors was 7%. The latter figure is similar to the average inside ownership of 6.77% observed by Musteen et al. (2009). Yermack (1996) reported a combined 9.1% ownership for inside and outside directors.

Table 5.1 Descriptive Statistics and Pearson Correlations (N=453)

	Mean	s.d.	1	2	3	4	5	6	7	8	9
1.12-month BHAR	-0.08	0.34	___								
2. Acquiror industry ^a	0.64	0.48	0.10*	___							
3. Acquiror size	8.42	1.60	0.13**	0.13**	___						
4. Acquiror ROA	0.02	0.15	0.11*	0.07	0.30***	___					
5. Acquiror advertising intensity	0.08	0.12	-0.05	-0.17***	-0.06	-0.01	___				
6. Acquisition relatedness ^b	0.50	0.50	0.02	0.02	0.03	-0.05	0.03	___			
7. Governance difference	1.08	1.10	0.07	0.09 ⁺	-0.02	-0.00	-0.03	-0.01	___		
8. Home country business cycle ^c	0.92	0.28	-0.03	0.01	-0.01	-0.03	-0.03	0.00	0.04	___	
9. Host country GDP growth	0.09	0.05	-0.05	-0.02	-0.11*	-0.01	0.11*	0.10*	-0.03	-0.01	___
10. Host country political risk	16.96	6.56	-0.02	-0.00	-0.03	-0.03	0.05	0.09*	0.09 ⁺	0.16***	0.08 ⁺
11. Cultural distance	0.84	0.99	-0.11*	0.06	-0.01	0.06	0.05	-0.05	0.39***	0.03	0.19***
12. Acquiror acquisition experience	1.95	2.82	-0.04	-0.02	0.27***	0.08 ⁺	0.04	-0.03	0.00	-0.06	0.01
13. Acquiror international experience	0.30	0.23	-0.02	0.21***	0.09 ⁺	-0.03	0.01	0.05	0.02	0.07	-0.02
14. Acquiror presence in host country ^d	0.30	0.46	0.03	0.14	0.29***	0.03	-0.02	-0.01	-0.03	0.02	-0.08 ⁺
15. Board size	9.34	2.73	0.21***	0.09 ⁺	0.47***	0.19***	-0.08 ⁺	0.04	-0.02	0.03	-0.02
16. Director reputation	1.12	0.84	0.02	0.03	0.24***	0.01	-0.02	-0.11*	-0.08 ⁺	0.06	-0.12*
17. Outside director tenure	6.58	3.87	0.24***	0.11*	0.29***	0.20***	-0.06	-0.03	0.06	-0.07	-0.14**
18. CEO influence			0.16***	-0.06	0.09*	0.08 ⁺	0.02	0.08 ⁺	0.07	-0.02	-0.07
19. Active institutional ownership	0.44	0.19	0.03	0.14**	0.28***	0.21***	-0.13**	-0.10	0.01	-0.00	-0.05
20. Outside director ownership	0.01	0.02	0.07	-0.02	-0.24***	-0.06	-0.04	-0.05	-0.07	0.01	-0.03
21. Inside director ownership	0.07	0.11	0.10*	-0.06	-0.18***	-0.01	0.03	0.05	-0.01	-0.00	0.00

Table 5.1 – *Continued*

	10	11	12	13	14	15	16	17	18	19	20
10. Host country political risk	_____										
11. Cultural distance	0.31***	_____									
12. Acquiror acquisition experience	-0.04	0.12*	_____								
13. Acquiror international experience	0.05	0.07	0.31***	_____							
14. Acquiror presence in host country ^b	-0.09 ⁺	0.17	0.19***	0.24***	_____						
15. Board size	-0.01	-0.06	0.13**	-0.04	-0.19***	_____					
16. Director reputation	0.06	-0.04	0.05	-0.05	-0.06	0.21***	_____				
17. Outside director tenure	0.03	0.01	0.07	0.04	-0.16***	0.23***	0.03	_____			
18. CEO influence	-0.00	-0.03	0.08 ⁺	-0.02	-0.02	-0.04	-0.18	0.18***	_____		
19. Active institutional ownership	-0.12	-0.03	0.14	0.11	-0.25***	0.16***	0.01	0.22***	-0.12**	_____	
20. Outside director ownership	0.05	-0.05	-0.11*	-0.00	0.07	-0.05	0.10	-0.02	-0.01	-0.11*	_____
21. Inside director ownership	0.10*	0.03	-0.05	0.01	0.15	-0.20***	-0.18***	-0.13**	0.34***	-0.34***	0.11*

^a 1=Manufacturing industry; 0=Non-manufacturing industry.

^b 1=Related acquisition; 0=Unrelated acquisition.

^c 1=acquisition year is 1991, 2001; 0=Otherwise.

^d 1=Present in host country; 0=Absent in host country.

+ $p < 0.10$, * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$.

Also, the correlation matrix indicates that all correlations were below 0.40 (except between acquirer firm size and board size) suggesting that multicollinearity was not a problem in this study. Further evidence of the absence of serious multicollinearity comes from the VIF (variance inflation factor) values associated with predictor variables. They were all less than 2, well below the cutoff value of 10 identified by Neter, Wasserman, and Kutner (1990) and Cohen, Cohen, West, and Aiken (2003).

5.2 Long-Term Shareholder Wealth Effect

Long-run abnormal returns were computed by comparing firm returns over a window that began one month after the merger completion date to the benchmark portfolio. Details of the procedure used in the computation of the BHARs are provided in Lyon et al. (1999) and Black et al. (2007). In the 1-year window following the completion of the cross-border acquisition, the number of acquisitions that experienced negative returns outnumbered those that created shareholder wealth. While 62% of the cross border acquisitions in my sample resulted in shareholder wealth reduction for acquiring firm shareholders, only 38% resulted in shareholder wealth creation. The mean BHAR (buy and hold abnormal returns) across all the acquisitions in the sample was negative (-0.0849) but statistically non-significant ($p = 0.497$). These findings suggest that cross-border acquisitions, on average, do not create shareholder value in the long-run. Thus, Hypothesis 1 was not supported.

5.3 OLS Robust Regression Results for Main Effects

The results of the OLS regression using the cluster option in STATA 11 of the effects of board and ownership variables on the 1-year abnormal return are presented in Table 5.2. Model 1 represents the regression model with the control and contingency variables. Model 2 incorporates the predictor variables related to board structure and model 3 the ownership variables. Model 4 represents the full model. As seen from model 1, the control and contingency variables accounted for 6.61% ($p < 0.01$) of the variance in bidder returns in the 12 month period following the acquisition (i.e., the 12 month BHAR). Acquiring firm industry was

consistently, from models 1 through 4, found to have a positive effect on bidder shareholder value ($p < 0.10$). This indicates that firms in the manufacturing sector were more likely to generate wealth for their shareholders when undertaking cross-border acquisitions than those in the service sector. Bidding firm size was also positively associated with the 12-month BHAR wealth effect but only in models 1 and 3.

Among the contingency variables, cultural distance and national governance differences were found to have a significant effect on 12-month BHARs. Cultural distance had a negative effect ($p < 0.001$), which implies acquisitions involving firms in countries that are culturally distant result in lower returns. National governance difference, on the other hand, had a positive effect ($p < 0.01$), which, surprisingly, suggests that acquisitions in countries with less stringent shareholder protection regimes translate to higher returns for U.S. firms.

The addition of board characteristic variables resulted in an incremental R^2 of 6.85% ($p < 0.001$). Board size and average outside director tenure were both positively associated with shareholder wealth effects (at $p < 0.001$) in the post-acquisition one year period. These results provide support for Hypotheses 2 and 4 wherein I argued that in acquisitions involving firms in foreign markets, larger boards and greater outside director tenure contribute to higher returns. CEO influence was also found to be a significant predictor (at $p < 0.01$) of long-term shareholder wealth but the direction was opposite to that I hypothesized. Hence, Hypothesis 5 was not

Table 5.2 Clustered Regression Results: Board and Ownership Variables (N=453)

Variables	Model 1	Model 2	Model 3	Model 4
Acquiror industry	0.061 ⁺ (0.033)	0.055 ⁺ (0.032)	0.063* (0.032)	0.056 ⁺ (0.031)
Acquiror size	0.023* (0.011)	-0.003 (0.012)	0.032** (0.011)	0.005 (0.012)
Acquiror ROA	0.204 (0.139)	0.118 (0.138)	0.181 (0.146)	0.097 (0.145)
Acquiror advertising intensity	-0.031 (0.110)	-0.009 (0.102)	-0.015 (0.111)	0.006 (0.101)

Table 5.2 – Continued

Home country business cycle	-0.032 (0.055)	-0.024 (0.058)	-0.029 (0.055)	-0.020 (0.058)
Host country GDP growth	-0.044 (0.304)	0.091 (0.307)	0.015 (0.304)	0.143 (0.309)
Host country political risk	0.001 (0.002)	0.000 (0.002)	0.001 (0.002)	-0.000 (0.002)
Cultural distance	-0.060*** (0.018)	-0.052** (0.018)	-0.058** (0.018)	-0.051** (0.018)
Governance difference	0.041** (0.015)	0.034** (0.014)	0.044** (0.014)	0.037** (0.014)
Acquiror acquisition experience	-0.006 (0.006)	-0.008 (0.006)	-0.005 (0.006)	-0.007 (0.006)
Acquiror international experience	-0.029 (0.070)	0.006 (0.067)	-0.045 (0.070)	-0.010 (0.066)
Acquisition relatedness	0.010 (0.031)	0.003 (0.030)	0.010 (0.031)	0.003 (0.031)
Acquiror presence in host country	-0.020 (0.036)	-0.032 (0.034)	-0.011 (0.036)	-0.025 (0.033)
Board size		0.021*** (0.006)		0.021*** (0.006)
Director reputation		0.008 (0.017)		0.009 (0.017)
Outside director tenure		0.014*** (0.004)		0.015*** (0.005)
CEO influence		0.076** (0.025)		0.060* (0.027)
Active institutional owner			0.030 (0.094)	0.017 (0.092)
Outside director ownership			1.387** (0.577)	1.206* (0.539)
Inside director ownership			0.367** (0.143)	0.383** (0.157)
R-squared	0.0661**	0.1346***	0.0897***	0.1566***
Incremental R-squared		0.0685	0.0236	0.0905

+ $p < .10$, * $p < .05$, ** $p < .01$, *** $p < .001$

supported. My findings on the impact of CEO influence suggest that such influence has a positive effect on acquisition returns in cross border transactions. The regression coefficient associated with director reputation was in the expected direction; however, it was not statistically significant. In other words, hypothesis 3 was not supported.

The inclusion of ownership variables in model 3 explained an additional 2.36% of the variance in the dependent variable ($p < 0.001$). While, ownership by active institutional owners was not found to have a significant effect, both outsider and insider director ownership contributed positively to bidding firm shareholder value in the year following the acquisition (at $p < 0.01$ for both). These results provide support for Hypotheses 7 and 8 but not Hypothesis 6.

5.4 Moderated OLS Regression Results for Contingency Effects

Based on the hypotheses presented in Chapter 3, I examined the contingency effects associated with target country GDP growth and country risk, cultural distance, acquiror acquisition and international experience, and acquiror existing presence in the target country. To assess the contingency effects of firm and environmental factors I entered the interaction variables between each contingency factor and the governance variables. The moderated multiple regression results can be found in Tables 5.3 through 5.8. The inclusion of the interaction terms involving the 6 contextual factors did not change the most of the main effects that were observed earlier. In other words, acquiring firms coming from the manufacturing industry or entering countries with similar national culture or different governance systems compared to the U.S. were still associated with more positive abnormal returns 12 months post-acquisition. Among the governance variables, board size, outside director tenure, CEO influence, and outside and inside director ownership were all found to be positively related to 12-month shareholder returns on the acquisition for bidding firms.

As the results presented in Table 5.3 indicate, the interaction between GDP growth and board size was significantly associated with 12-month BHARs. I

Table 5.3 Moderated Clustered Regression Results: Host Country GDP Growth

Variables	Coefficient	Std. error
Acquiror industry	0.060*	0.031
Acquiror size	0.006	0.012
Acquiror ROA	0.094	0.145
Acquiror advertising intensity	0.021	0.102
Acquisition relatedness	0.003	0.031
Governance difference	0.037**	0.014
Home country business cycle	-0.017	0.058
Host country GDP growth	0.180	0.337
Host country political risk	-0.001	0.002
Cultural distance	-0.052**	0.018
Acquiror acquisition experience	-0.007	0.006
Acquiror international experience	-0.010	0.066
Acquiror presence in host country	-0.025	0.034
Board size	0.022***	0.006
Director reputation	0.008	0.018
Outside director tenure	0.015***	0.005
CEO influence	0.057*	0.027
Active institutional ownership	0.012	0.093
Outside director ownership	1.197*	0.547
Inside director ownership	0.401*	0.159
Board size X GDP growth	0.183 ⁺	0.103
Director reputation X GDP growth	-0.240	0.364
Outside director tenure X GDP growth	-0.006	0.079
CEO influence X GDP growth	0.254	0.567
R-squared	0.1607***	

+ $p < .10$, * $p < .05$, ** $p < .01$, *** $p < .001$

graph the significant interaction effects within each contingency factor following the procedures identified by Aiken and West (1991). Figure 5.1 illustrates the moderating effects of host country GDP growth on the relationship between board size and BHAR12. When firms acquire international targets from countries with low GDP growth, a bigger board does not appear to result in significantly better acquisition related returns. However, when acquiring targets from countries exhibiting high GDP growth, acquiring firms with bigger boards on average generate positive shareholder returns on their acquisitions compared to negative shareholder returns by acquiring firms with smaller boards. In sum, the findings suggest that a bigger board is more important in generating shareholder wealth in cross border acquisitions made in countries characterized by high GDP growth. In other words, only Hypothesis 9A was supported in the context of the host country growth.

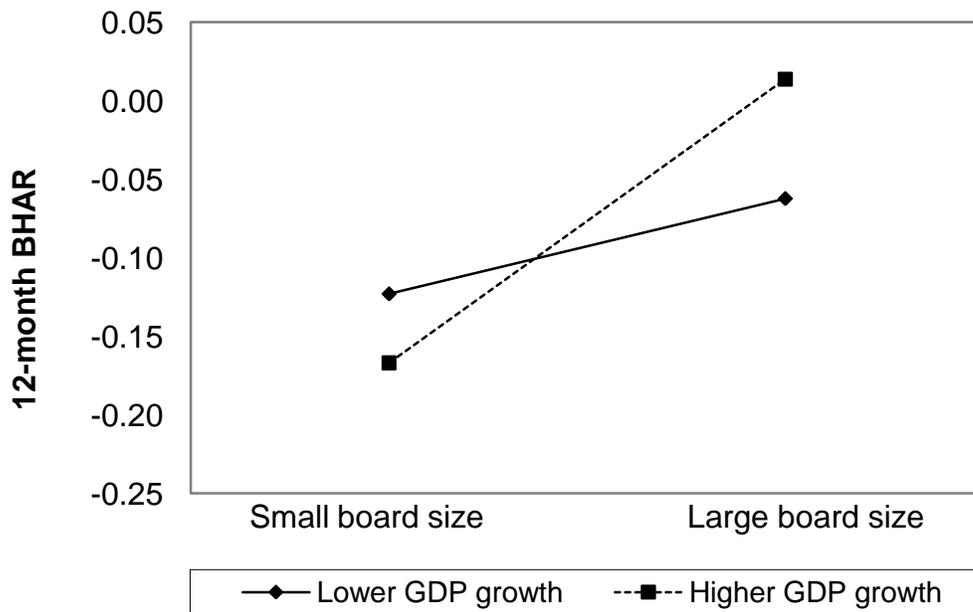


Figure 5.1. Interaction Effect between Board Size and Host Country GDP Growth on 12-month BHAR

Table 5.4 Moderated Clustered Regression Results: Host Country Political Risk

Variables	Coefficient	Std. error
Acquiror industry	0.055 ⁺	0.031
Acquiror size	0.008	0.012
Acquiror ROA	0.110	0.155
Acquiror advertising intensity	0.013	0.100
Acquisition relatedness	0.008	0.031
Governance difference	0.035 ^{**}	0.014
Home country business cycle	-0.012	0.058
Host country GDP growth	0.157	0.297
Host country political risk	-0.000	0.002
Cultural distance	-0.049 ^{**}	0.018
Acquiror acquisition experience	-0.006	0.005
Acquiror international experience	-0.020	0.066
Acquiror presence in host country	-0.031	0.034
Board size	0.021 ^{***}	0.006
Director reputation	0.009	0.018
Outside director tenure	0.014 ^{**}	0.005
CEO influence	0.064 ^{**}	0.028
Outside director ownership	1.202 [*]	0.533
Inside director ownership	0.353 [*]	0.158
Board size X Political risk	-0.000	0.001
Director reputation X Political risk	0.002	0.002
Outside director tenure X Political risk	-0.001 ⁺	0.001
CEO influence X Political risk	0.009 [*]	0.004
R-squared	0.1715 ^{***}	

+ $p < .10$, * $p < .05$, ** $p < .01$, *** $p < .001$

The results of the multiple regression analysis on the moderating effects of target country political risk are reported in Table 5.4. It appears that the impact of outside director tenure and CEO influence on shareholder returns in cross-border acquisitions depends on the

level of political risk in the host country. As depicted in Figure 5.2, outside directors with a longer tenure on the board contribute more to long-term shareholder returns in the context of acquisitions made in low political risk countries than those in high risk countries. In other words, the findings are contrary to what I had hypothesized. Hence, no support for Hypothesis 10C, along with Hypotheses 10A and 10B, was found. In addition, Figure 5.3 depicts the moderating effects of political risk on the relationship between CEO influence and long-run returns. While CEO influence does not seem to make a difference when the target firm is from a country characterized by low levels of political risk, the graph for acquisitions made in high political risk countries indicates that the positive effects of CEO influence on shareholder gains were more pronounced in such contexts. This lends support for Hypothesis 10D.

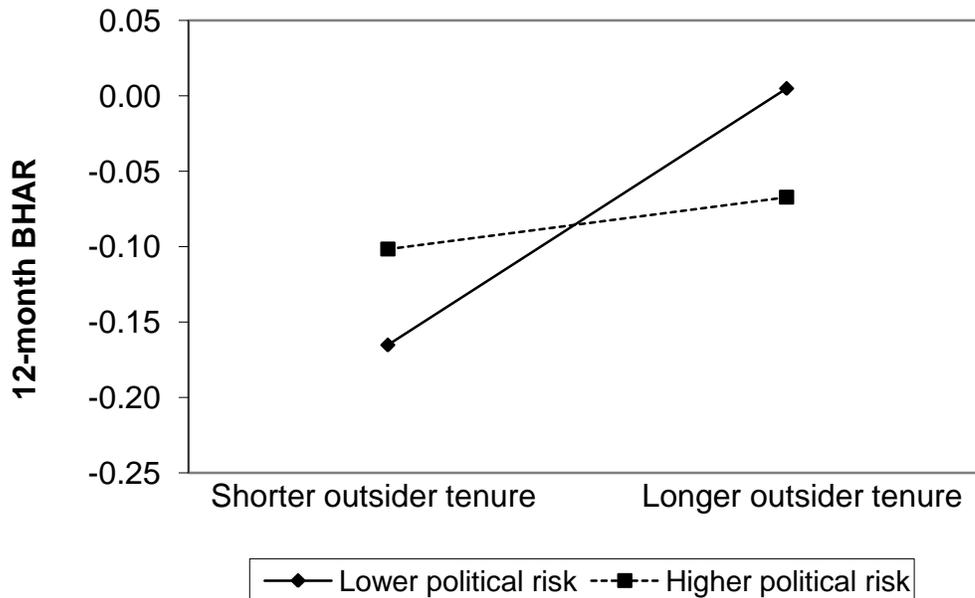


Figure 5.2. Interaction Effect between Outside Director Tenure and Host Country Political Risk on 12-month BHAR

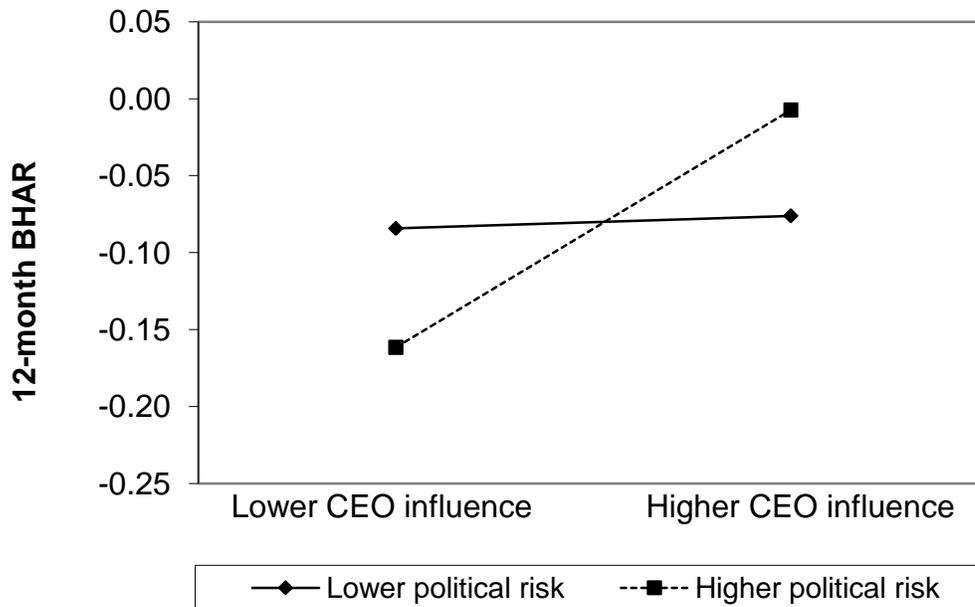


Figure 5.3. Interaction Effect between CEO Influence and Host Country Political Risk on 12-month BHAR

The results of the regression analysis on the moderating effects of cultural distance are presented in Table 5.5. They indicate that the positive relationship between both board size and 12-month abnormal returns is contingent on the cultural distance between the acquiring and acquired firms' countries. As depicted in Figure 5.4, in the acquisition of firms in countries characterized by less cultural distance (i.e., countries with similar cultures as the U.S.), acquirers with larger boards experience higher long-term returns from their acquisitions. However, this improvement is more pronounced in the acquisition of targets in more culturally distant countries. In other words, Hypothesis 11A was supported by my data. In addition, from Figure 5.5, my results indicate that firms with higher director reputation have lower shareholder returns when acquiring firms in countries with similar cultures. On the other hand, higher director reputation has a more positive effect on shareholder returns for firms acquiring targets from more culturally distant countries. Thus, I found support for Hypothesis 11B as well.

Table 5.5 Moderated Clustered Regression Results: Cultural Distance

Variables	Coefficient	Std. error
Acquiror industry	0.051 ⁺	0.031
Acquiror size	0.005	0.012
Acquiror ROA	0.110	0.147
Acquiror advertising intensity	-0.005	0.096
Acquisition relatedness	-0.003	0.031
Governance difference	0.036 ^{**}	0.014
Home country business cycle	-0.037	0.057
Host country GDP growth	0.184	0.304
Host country political risk	-0.000	0.002
Cultural distance	-0.046 ^{**}	0.017
Acquiror acquisition experience	-0.008	0.006
Acquiror international experience	0.012	0.065
Acquiror presence in host country	-0.019	0.034
Board size	0.025 ^{***}	0.006
Director reputation	0.010	0.017
Outside director tenure	0.014 ^{**}	0.004
CEO influence	0.063 [*]	0.027
Active institutional ownership	0.017	0.092
Outside director ownership	1.445 ^{**}	0.851
Inside director ownership	0.404 ^{**}	0.151
Board size X Cultural distance	0.011 ⁺	0.006
Director reputation X Cultural distance	0.050 ^{**}	0.019
Outside director tenure X Cultural distance	-0.004	0.005
CEO influence X Cultural distance	-0.012	0.029
R-squared	0.1792 ^{***}	

+ $p < .10$, * $p < .05$, ** $p < .01$, *** $p < .001$

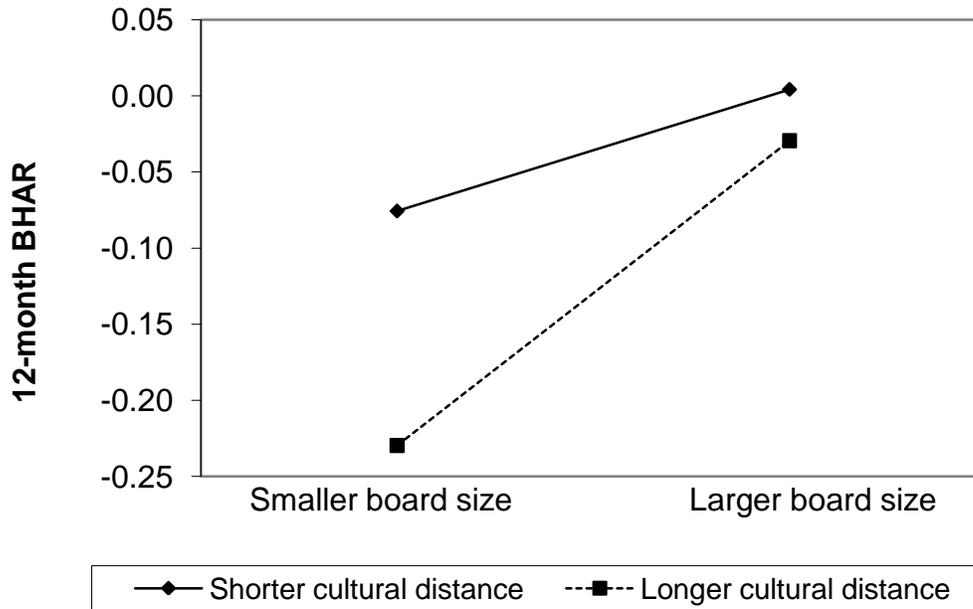


Figure 5.4. Interaction Effect between Board Size and Cultural Distance on 12-month BHAR

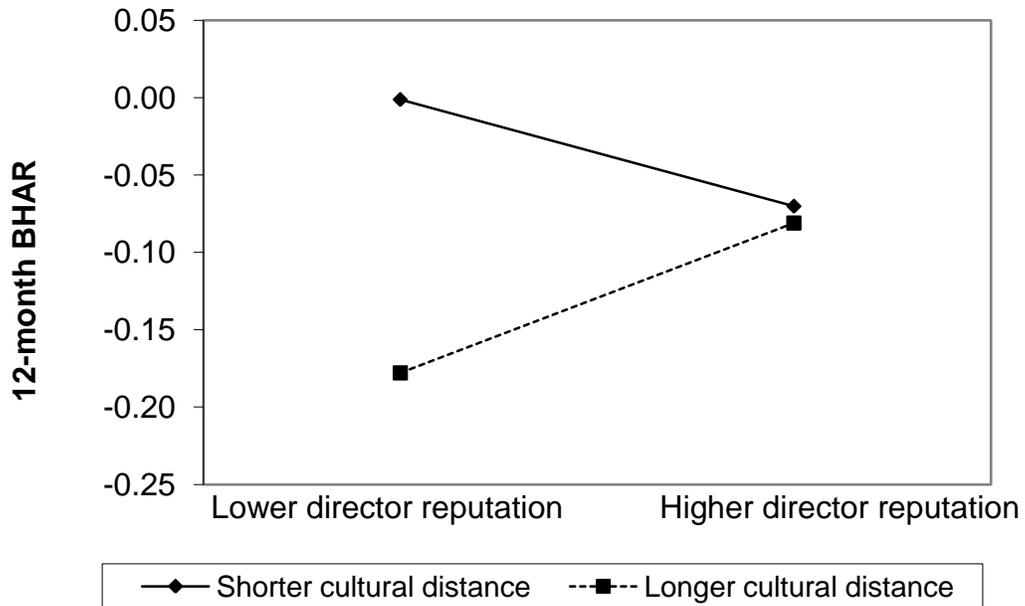


Figure 5.5. Interaction Effect between Director Reputation and Cultural Distance on 12-month BHAR

Results pertaining to the moderating effects of the acquisition experience of bidding firms on their acquisition related returns are presented in Table 5.7. As seen in the table, acquisition experience along with outside director tenure results in significant long-term abnormal gains in cross-border acquisitions. For acquiring firms with more acquisition experience, having outside directors with longer tenures translate to slightly greater long-term abnormal returns (see Figure 5.6). However, the benefits are much more pronounced when acquiring firms have limited acquisition experience. In such cases, greater improvement in shareholder gains was observed for acquiring firms with higher levels of outside director tenure. This is opposite to that hypothesized wherein from a TCE perspective, the increased in frequency in the deployment of asset-specific skills, in this case, acquisition experience, leads to decreased transaction costs and thereby more positive shareholder returns.

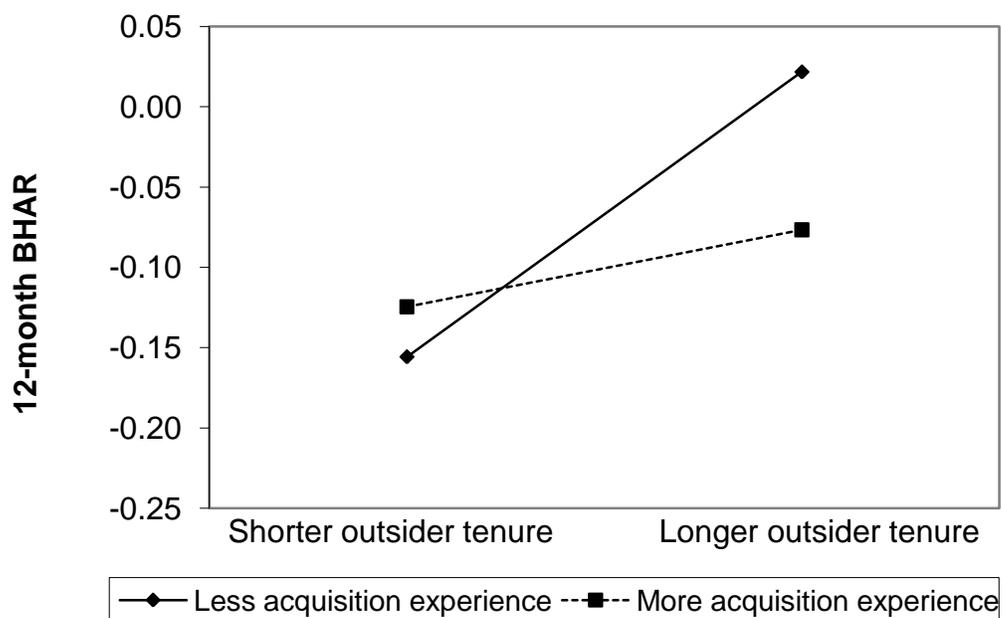


Figure 5.6. Interaction Effect between Outside Director Tenure and Acquisition Experience on 12-month BHAR

Table 5.6 Moderated Clustered Regression Results: Acquisition Experience

Variables	Coefficient	Std. error
Acquiror industry	0.061*	0.031
Acquiror size	0.003	0.012
Acquiror ROA	0.094	0.147
Acquiror advertising intensity	0.005	0.099
Acquisition relatedness	0.005	0.031
Governance difference	0.035**	0.014
Home country business cycle	-0.028	0.058
Host country GDP growth	0.186	0.311
Host country political risk	-0.000	0.002
Cultural distance	-0.049**	0.018
Acquiror acquisition experience	-0.006	0.006
Acquiror international experience	-0.016	0.066
Acquiror presence in host country	-0.031	0.035
Board size	0.022***	0.006
Director reputation	0.008	0.017
Outside director tenure	0.015**	0.005
CEO influence	0.060*	0.029
Active institutional ownership	0.025	0.093
Outside director ownership	1.175*	0.539
Inside director ownership	0.389**	0.162
Board size X Acquisition experience	0.003	0.002
Director reputation X Acquisition experience	-0.006	0.006
Outside director tenure X Acquisition experience	-0.003 ⁺	0.002
CEO influence X Acquisition experience	-0.006	0.007
R-squared	0.1655***	

+ $p < .10$, * $p < .05$, ** $p < .01$, *** $p < .001$

Table 5.7 reports the moderated multiple regression results involving the interactions between firm governance variables and the acquiring firm's international experience. Among the interaction effects involving the board structure, only the influence of board size on long-term shareholder wealth effect was found to be conditional on the level of international experience of the acquiring firm. As demonstrated in Figure 5.7, when firms with limited international experience enter foreign markets through acquisitions, a larger board size marginally improves the long-term shareholder performance associated with the acquisition. This improvement related to an increase in board size, however, is more pronounced when acquiring firms with more international experience undertake cross-border acquisitions. Thus, Hypotheses 13A was supported, while the rest of the hypotheses pertaining to the interaction effects with international experience were not.

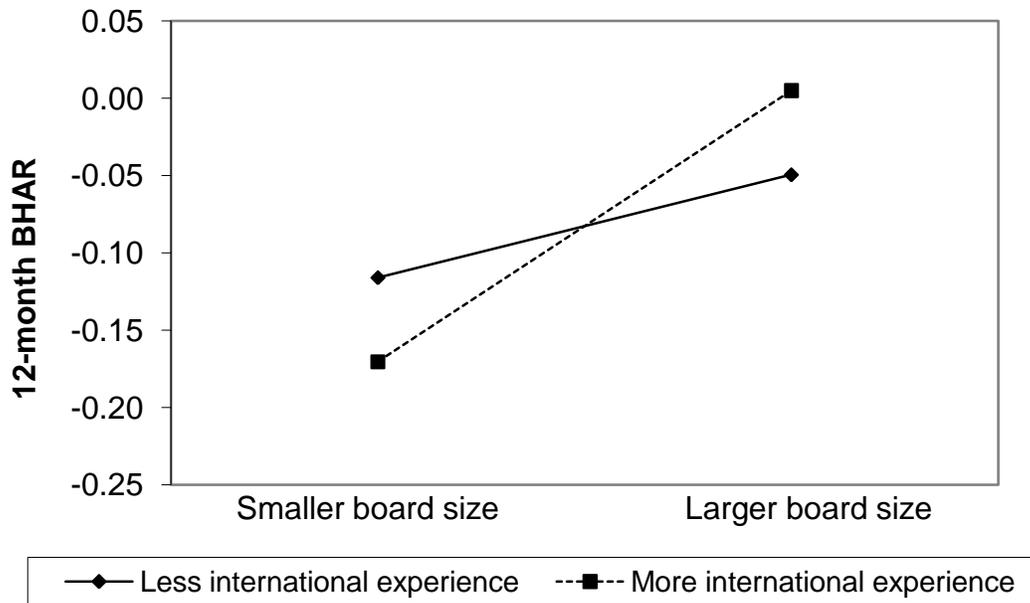


Figure 5.7. Interaction Effect between Outside Director Tenure and International Experience on 12-month BHAR

Table 5.7 Moderated Clustered Regression Results: International Experience

Variables	Coefficient	Std. error
Acquiror industry	0.056 ⁺	0.031
Acquiror size	0.005	0.012
Acquiror ROA	0.096	0.146
Acquiror advertising intensity	0.004	0.103
Acquisition relatedness	-0.002	0.031
Governance difference	0.037 ^{**}	0.014
Home country business cycle	-0.027	0.057
Host country GDP growth	0.176	0.310
Host country political risk	-0.000	0.002
Cultural distance	-0.051 ^{**}	0.018
Acquiror acquisition experience	-0.008	0.006
Acquiror international experience	-0.001	0.067
Acquiror presence in host country	-0.026	0.034
Board size	0.022 ^{***}	0.006
Director reputation	0.011	0.018
Outside director tenure	0.015 ^{***}	0.005
CEO influence	0.060 [*]	0.028
Active institutional ownership	0.024	0.094
Outside director ownership	1.098 [*]	0.555
Inside director ownership	0.395 ^{**}	0.154
Board size X International experience	0.044 ⁺	0.024
Director reputation X International experience	0.037	0.070
Outside director tenure X International experience	-0.020	0.016
CEO influence X International experience	0.004	0.106
R-squared	0.1645 ^{***}	

+ $p < .10$, * $p < .05$, ** $p < .01$, *** $p < .001$

Finally, in Table 5.8, the hypotheses on the differential shareholder wealth effect of board and ownership structures when firms make acquisitions in countries where the acquiring firm already has existing presence. As seen in Figure 5.8, my study results indicate that an U.S. acquiring firm entering a foreign country for the first time using an acquisition benefits from the presence of longer tenured outside directors. However, when acquiring targets in a country where the firm already has presence, only longer outsider tenure was found to result in greater improvements in long-term shareholder returns. This lends support to Hypothesis 14C while the rest of the hypotheses related to the contingency effects of country presence were not supported.

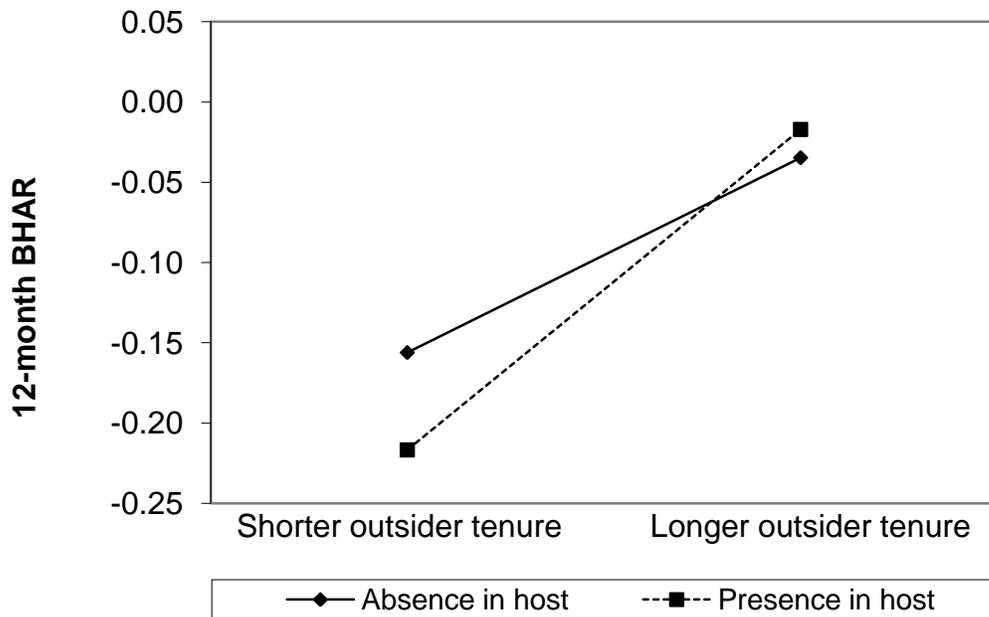


Figure 5.8. Interaction Effect between Outside Director Tenure and Acquiror Presence in Host Country on 12-month BHAR

Table 5.8 Moderated Clustered Regression Results: Acquiror Presence in Host Country

Variables	Coefficient	Std. error
Acquiror industry	0.052 ⁺	0.031
Acquiror size	0.006	0.012
Acquiror ROA	0.098	0.151
Acquiror advertising intensity	-0.006	0.102
Acquisition relatedness	0.006	0.031
Governance difference	0.035 ^{**}	0.014
Home country business cycle	-0.022	0.058
Host country GDP growth	0.105	0.307
Host country political risk	0.000	0.002
Cultural distance	-0.048 ^{**}	0.018
Acquiror acquisition experience	-0.007	0.006
Acquiror international experience	-0.023	0.067
Acquiror presence in host country	-0.043	0.034
Board size	0.022 ^{***}	0.006
Director reputation	0.010	0.017
Outside director tenure	0.015 ^{***}	0.005
CEO influence	0.062 [*]	0.027
Active institutional ownership	0.037	0.094
Outside director ownership	1.271 [*]	0.545
Inside director ownership	0.303 ⁺	0.162
Board size X Acquiror presence	0.006	0.012
Director reputation X Acquiror presence	0.012	0.034
Outside director tenure X Acquiror presence	0.022 ^{**}	0.009
CEO influence X Acquiror presence	-0.060	0.054
R-squared	0.1695 ^{***}	

+ $p < .10$, * $p < .05$, ** $p < .01$, *** $p < .001$

5.5 Supplementary Analysis: 24-Month BHAR

To examine whether the main effects of the board and ownership variables on shareholder wealth creation are also prevalent in the context of longer time periods, I conducted supplementary analysis using an observation window of 2 years following the acquisitions in my sample. The total sample was lower with 409 transactions (vs. 453 transactions for the 12-month BHAR). Much of this decrease can be attributed to other transactions by acquiring firms during the 2 year period following an acquisition. Some of these cases were included when the shorter 12-month time frame was used. In addition, a few acquiring firms included in the 12-month BHAR sample were excluded when they became acquisition targets themselves. The 409 transactions were undertaken by 368 unique acquiring firms (i.e., clusters). The BHARs associated with the 2-year window were consistent with those observed for the 1-year window. Acquisitions that were associated with shareholder value losses still outnumbered those that resulted in shareholder gains (66% vs. 34%). Moreover, the mean abnormal return was negative at -13.57%. However, it was not statistically significant. Likewise, the median abnormal return of -17.63% was also not statistically significant. Table 5.9 reports the regression results for the 24-month BHAR for the cross-border acquisitions in my sample. The incremental R-square associated with the predictor variables was lower when compared to that observed in the context of the 12-month BHAR (9.63% vs. 15.70% in model 4). Among the control and moderator variables, only the significant positive shareholder wealth effect associated with manufacturing firms held in the 2-year window. Acquiror size, which was found to have a substantial positive association with shareholder wealth for the 12 month period was no longer a significant factor in explaining the 24-month returns. On the other hand, acquiring firm profitability exhibited a significant positive relationship to the 2-year abnormal return. The positive and significant effects on board size, outside director tenure, and CEO influence on shareholder gains for acquiring firms also remained in the 2-year horizon. However, the significant effects of the difference in national governance systems, cultural distance, and

director ownership (insider and outsider) no longer persisted in the 2-year period following cross-border acquisitions.

Table 5.9 Clustered Regression Results: Board and Ownership Variables (N=409)

Variables	Model 1	Model 2	Model 3	Model 4
Acquiror industry	0.106* (0.053)	0.104* (0.053)	0.110* (0.053)	0.107* (0.055)
Acquiror size	0.023 (0.017)	-0.010 (0.020)	0.031 ⁺ (0.018)	-0.004 (0.020)
Acquiror ROA	0.363** (0.127)	0.267* (0.129)	0.341** (0.130)	0.244 ⁺ (0.134)
Acquiror advertising intensity	-0.121 (0.190)	-0.103 (0.176)	-0.102 (0.190)	-0.080 (0.176)
Home country business cycle	-0.088 (0.093)	-0.085 (0.094)	-0.088 (0.093)	-0.085 (0.094)
Host country GDP growth	-0.142 (0.458)	0.057 (0.475)	-0.100 (0.467)	0.086 (0.482)
Host country political risk	-0.000 (0.004)	-0.002 (0.003)	-0.001 (0.004)	-0.002 (0.004)
Cultural distance	-0.040 (0.018)	-0.035 (0.031)	-0.039 (0.031)	-0.035 (0.031)
Governance difference	0.019 (0.025)	0.012 (0.025)	0.021 (0.026)	0.014 (0.025)
Acquiror acquisition experience	0.008 (0.010)	0.005 (0.009)	0.008 (0.010)	0.005 (0.009)
Acquiror international experience	0.012 (0.130)	0.056 (0.129)	-0.007 (0.128)	0.038 (0.126)
Acquisition relatedness	-0.010 (0.050)	-0.023 (0.049)	-0.012 (0.050)	-0.024 (0.049)
Acquiror presence in host country	-0.056 (0.061)	-0.063 (0.058)	-0.049 (0.060)	-0.059 (0.058)
Board size		0.026** (0.011)		0.027* (0.011)
Director reputation		0.016 (0.029)		0.018 (0.030)
Outside director tenure		0.016* (0.007)		0.016* (0.007)

Table 5.9 – *Continued*

CEO influence		0.100* (0.047)		0.087+ (0.049)
Active institutional owner			0.040 (0.146)	0.052 (0.146)
Outside director ownership			1.395 (1.447)	1.159 (1.376)
Inside director ownership			0.291 (0.284)	0.316 (0.290)
R-squared	0.0464**	0.0901***	0.0533**	0.0963***
Incremental R-squared		0.0437	0.0069	0.0499

+ $p < .10$, * $p < .05$, ** $p < .01$, *** $p < .001$

CHAPTER 6
DISCUSSION, RESEARCH CONTRIBUTIONS, MANAGERIAL IMPLICATIONS, STUDY
LIMITATIONS, AND DIRECTIONS FOR FUTURE RESEARCH

6.1 Discussion

With increasing resources being devoted by firms to cross-border acquisitions, it would be logical to expect that such acquisitions ought to generate shareholder value for bidding firm shareholders. Indeed there have been a number of studies in the areas of finance, international business and strategic management that have sought to examine the wealth effects associated with such acquisitions. Most of these studies that have looked at value creation using event studies have examined bidding firm wealth effects associated with the announcement of cross-border acquisitions over short windows surrounding announcement dates (including, most commonly, the two-day (-1,0) window). The results of these studies, however, provide a somewhat incomplete picture of acquisition performance. That is because the underlying assumption is that investors are able to fully comprehend and incorporate all information pertaining to the acquisition at the time of the announcement in their valuation. This presupposes that investors are able to assess how well the acquisition will unfold over time and the ability of bidding firm management to address the many challenges that they face in their implementation of the acquisition. In reality, much of the information relevant to value creation in a cross-border acquisition from the perspective of a bidding firm is unlikely to be available to investors until the acquisition is consummated and the implementation process begins. Use of longer post-acquisition windows provides a better insight into the acquisition's contribution to shareholder wealth effects. Recent methodological advancements in the area of finance (e.g., Johnson, Moorman, & Sorescu, 2009; Lyon et al., 1999; Mitchell & Stafford, 2000) have

provided researchers with tools that enable them to estimate shareholder value creation in the context of longer time frames (i.e., one year or more).

While the findings of past research on the wealth effects associated with cross-border acquisitions have been equivocal with some studies (e.g., Black et al., 2007; Datta & Puia, 1995) finding that cross-border acquisitions, on average, destroy shareholder value for bidding firms, I found that the effects, while negative, are not statistically significant. Based on my data and analysis of the same, it appears that, acquiring firms in cross-border acquisitions exhibit negative abnormal gains in the year following the transaction that those exhibiting positive returns by nearly a two to one margin. However, because long-term abnormal returns are positively skewed, adopting the bootstrap-adjusted *t*-statistic following Lyon et al. (1999) revealed that the negative returns are not significantly different from zero. While Black, et al. (2007) too adopted the BHAR methodology in computing for long-run abnormal returns, the time frames are different; while my study looks at cross-border acquisitions between 1990 and 2006, Black, et al. (2007) used a sample of acquisitions undertaken between 1985-1995. Additionally, it is not clear whether they took into account cross-dependence arising from overlapping acquisitions which, once taken into consideration, often results in non-significant returns (Mitchell & Stafford, 2000). Datta and Puia's (1995) study involves cross-border acquisitions for an even earlier time period, namely, 1978 to 1990. It is quite likely that the greater challenges faced by firms (perceived and real) during a time period when acquisitions were relatively more uncommon might have contributed to the significant negative findings in the Datta and Puia (1995) study.

My findings are in consonance with those in the study undertaken by Gregory and McCorrison (2005). They also found non-significant negative shareholder returns for bidders in the 12-month post-acquisition period. However, their sample involved cross-border acquisitions by U.K. acquiring firms during the 1984-1995 period. Another study by Chakrabarti et al. (2009) observed non-significant, albeit positive, shareholder returns for acquiring firms within the

comparable period of 1991-2004. However, it must be noted that, unlike my study, their sample was not limited to U.S. acquiring firms. In addition, my findings do not support those of Boubakri, et al. (2008) and Gleason et al., (2006) who found significant positive wealth effects associated with cross-border acquisitions in the long term. However, these two studies were limited to acquisitions conducted within specific industries -- Boubakri, et al. (2008) in the insurance industry and Gleason et al. (2006) in the banking sector.

The implicit assumption in prior research on cross-border acquisition studies is that managers undertake such acquisitions based on economic considerations. The findings of this study suggests other, non-economic factors (e.g., those related to managerial interests, incentives and risk taking propensity), also probably play a key role in such decisions. For example, when a firm has a larger board monitoring managerial decisions and providing managers with the information and guidance they need in the making of cross-border acquisitions, the outcome is improved acquisition performance in the long-term. Our findings suggest that a complex strategy such as a cross-border acquisition has greater advisory needs and is likely to benefit from the expertise, experience and knowledge of a larger board. The counsel and advice provided by both outside and inside directors can benefit firms as they enter foreign markets. A key challenge in cross-border acquisitions relates to the difficulties faced by firms in identifying suitable acquisition candidates —one that has often be referred to as an important hurdle in the creation of value in such transactions. In this context, the networks of outside directors can be particularly valuable in seeking out attractive acquisition candidates in foreign markets. Inside directors, with their intimate knowledge of the capabilities and competencies of their firms, can provide value by educating the board on the relative desirability of alternative acquisition candidates from the standpoint of value creation (e.g., in the identification target firms that might best complement existing firm strengths or fill in resource gaps within their firms). In addition, the superior understanding that such directors have of firm operations and procedures and can be important in providing the guidance needed

to address the challenges that are likely to be faced during the post-acquisition assimilation process. Moreover, larger boards, comprising of both outsiders and insiders, bring in a broad range of expertise that allows for a more careful and accurate evaluation of the value creating potential of acquisitions. This is particularly true in the context of outside directors who often have a wealth of experience related to acquisitions and doing business in international markets. Inside directors, who are members of top management, are in a superior position to identify the means by which foreign acquisitions can potentially create value (because such information is not often not fully captured in reports that the outside directors have ready access to). My findings are not surprising – indeed, they are consistent with those that emerge from the meta-analysis conducted by Dalton et al. (1999) on the link between board size and overall firm performance. Thus, in the context of cross-border acquisitions, institutional pressures to reduce board size (e.g., Lipton & Lorsch, 1992; Yermack, 1996) may be detrimental to acquisition performance. While large boards have been associated with less cohesiveness and problems such as social loafing and higher coordination costs (Jensen, 1993), it appears that the benefits associated with larger board in terms of quality and quantity of advice (that is typically unavailable from corporate staff) outweighs the drawbacks.

Additionally, my research highlights the fact that longer director tenures can be beneficial from the standpoint of firms undertaking complex strategies such as cross-border acquisitions. Often, the literature associates tenure among outside directors with weak governance because of entrenchment issues and the fact that long tenured outside directors often develop close relationships with firm management that reduces the effectiveness of their monitoring role (Lipton & Lorsch, 1992; Vafeas, 2003). The findings of this study suggests otherwise. I found outside directors with longer tenure to be associated with better long-term performance in international acquisitions. It is quite likely that their superior knowledge of the firm and also the trusting relationship that they develop over time with firm management are advantageous in the context of such acquisitions and result in valuable guidance to top

management in the undertaking of acquisitions and their subsequent management. Moreover, their greater firm-related experience, when compared to outside directors with limited time in the firm's board, allows them to more effectively use their knowledge in balancing their monitoring and advisory roles. In sum, my results indicate that increases in the amount (from having more directors) and quality (from longer tenured directors) of monitoring may help mitigate agency problems related to cross-border acquisitions. The impact of board size, which represents a proxy for the breadth of resources (in terms of advice, counsel) available to the firm, and longer outside director tenure, which signifies a well-rounded perspective based on a mix of extensive knowledge of external markets and knowledge related to the inner workings of the firm, on cross-border acquisition performance also supports the resource dependency perspective that views directors, not just as monitors of top management but also as repositories of expertise and knowledge available to top management of the firms where they serve. The complexities surrounding cross-border acquisitions emphasize the importance of having outside directors on the board who possess both external market expertise and internal firm knowledge. My findings indicate that firms with such directors stand to benefit in their cross-border acquisition efforts.

A somewhat surprising result in my study involves the strong positive relationship between the extent of CEO influence and shareholder returns in international acquisitions. This runs counter to agency theory arguments that CEOs who are in a position to dominate the board (and, thereby, weaken board oversight) are more likely to act opportunistically in emphasizing their personal goals and objectives to the detriment of shareholder interests. However, the results are not totally unexpected. Having an influential CEO drive an international acquisition towards generating superior returns is consistent with the stewardship theory which views the CEO as having the same interests as shareholders in most situations (Davis, Schoorman, & Donaldson, 1997). Additionally, based on the arguments provided by Hermalin and Weisbach (1998), the influence of CEOs over the board is greater when their firms perform well. Therefore, in essence, CEOs with influence have a strong incentive to maximize

shareholder returns because doing so eventually results in their influence in the organization being enhanced. In other words, CEO influence is not necessarily associated with agency problems as agency theory arguments would suggest; instead the interests of influential CEOs are generally aligned of shareholders as they seek to increase such influence in their firm. Moreover, viewed from a “unity of direction” perspective, an influential CEO can prove to be invaluable in the execution of a complex strategy such as a cross-border acquisition. An influential CEO who oversees the acquisition can use his/her clout to ensure that the board remains focused and decisions are made within an optimal time frame to generate value.

My findings indicate that, in foreign acquisitions, greater equity ownership by both inside and outside directors result in superior returns. The positive effect of director ownership on long-term shareholder wealth is a testament to the desirability of using equity based incentives to align the interests of managers and directors. This is in agreement with the agency theory arguments wherein equity ownership is viewed as an incentive that mitigates agency problems in the context of strategic decisions. However, my supplementary analysis on value creation in the 24-month period following the acquisition points to an interesting anomaly. Ownership has a positive effect on shareholder value in the first 12 months following the completion of a cross-border transaction but the benefits dissipate over a longer period. Quite likely, with the longer time horizon, newer strategic initiatives undertaken by the firm becomes more salient to the directors. This lack of attention may have been instrumental in of the relationship between ownership and acquisition performance being more tenuous in the 24-month time period.

The non-significant findings associated with director reputation and ownership by active institutional shareholders may be a function of the way these two variables were operationalized. While director reputation, measured as the number of directorships held by directors, has been found to have a positive effect on the sales growth of the firm (Kor & Sundaramurthy, 2009), its effect on acquisition performance has been mixed. Subramanyam et

al. (1997) found director reputation to be instrumental in the creation of shareholder value in domestic acquisitions but Byrd and Hickman (1992) found no significant relationship between the average number of director ownership and 2-day announcement related returns on their sample of domestic acquisition. Perhaps, as alluded to by Carpenter and Westphal (2001), the contribution of well-connected directors goes beyond the number of ties they have as board members of other firms. In their study, Carpenter and Westphal (2001) further classified the director's affiliation based on strategic context and they found that a director's contribution to the firm's strategic decision making and monitoring and advisory functions is a function of their connections with other firms as it relates to the focal firm's strategic direction and the overall environment. In particular, within the context of stable environments (as measured by changes in industry concentration), directors with board memberships in firms related to the internationalization strategy of the focal firm were more involved in strategic decision making and more active in their monitoring and advising roles. On the other hand, in unstable environments, heterogeneity in director affiliations with respect to the firm's internationalization strategy resulted in greater strategic involvement and monitoring efficiency for directors. Thus, a finer grained measure of director reputation, compared to the number of outside directorships used in this study, may have explained a greater portion of the variance in cross-border acquisition performance among the sample firms.

Although institutional owners may be motivated by their substantial stake in the firm to have a greater say in the firm's strategic direction (e.g., Chen et al., 2007; Duggal & Millar, 1999; Kang, 1993; Wright et al., 2002), some studies (e.g., Coles & Hesterly, 2000; Mallette & Fowler, 1992) have found that the greater ownership by institutions does not necessarily translate to superior shareholder value. This was borne out of the meta-analysis undertaken by Sundaramurthy, Rhoades, and Rechner (2005) on the relationship between institutional ownership and firm performance. They failed to find any systematic relationship between the two. My finding on the effects of institutional ownership on cross-border acquisition

performance mirrors the observations of Sundaramurthy et al (2005). One possible explanation for this non-finding is that active institutional owners such as state and municipal pension funds do not employ managers skilled in evaluating the firms' long-term strategic initiatives such as cross-border acquisitions (Wohlstetter, 1993). Also, pension fund managers may be somewhat reluctant to question acquisition related decisions made by firm management, for fear of being reprimanded by their bosses who may have relationship, business or otherwise, with the acquiring firm managers (Jacobs, 1991). Alternatively, in the case of quasi-indexers, or institutional owners with low turnover and diversified ownership, they may just have too many firms in their portfolio which makes active monitoring by their managers in every firm a very challenging task.

The examination of contingency effects associated with environmental and firm related factors yielded some interesting findings. I found that while board size positively impacts shareholder value in international acquisitions, these positive effects are greater in acquisitions of firms in high growth and culturally distant countries. TCE arguments would suggest that a larger board enables acquiring firms to more effectively deal with the inherent environmental uncertainty and dynamism in high growth countries by providing higher levels of expertise and greater information processing capabilities. Similarly, the presence of more directors on the board can reduce internal uncertainty associated with the acquisition of a firm in a country with a dissimilar national culture. A larger board increases the likelihood of a director who has the knowledge and experience critical in entering culturally distant foreign markets. Likewise, acquisitions made in high-growth, dynamic markets can benefit from the knowledge originating from the board on what it takes to succeed in such an environment. The existence of a bigger board helps reduce the costs incurred by an acquiring firm in gathering and processing the information that is required to make better acquisition related decisions in such environments.

The relationship between board size and bidder shareholder gains is also observed to be more positive when firms acquiring foreign targets have a more extensive international experience. In the case of asset-specific knowledge such as experience in operating within international markets, TCE tenets suggest that a greater frequency in deploying such specific assets would result in lower transaction costs and eventually greater shareholder firm value. Larger boards enable acquiring firms to unlock greater shareholder value from cross-border acquisitions by actively scouting for foreign targets in countries or regions where the acquiring firm has greater international exposure.

While director reputation did not have a direct effect on acquisition-related shareholder returns, my study found that it was positively associated with value creation when firms engaged in acquisitions from culturally distant countries. As argued earlier, having directors who can use their experience and network links to facilitate acquisitions in culturally distant countries reduces transaction costs associated with undertaking and implementing such acquisitions. My findings are also consistent with the resource dependence view which posits that directors with multiple board seats can contribute to improved acquisition performance in culturally distant countries by using their experience to advise and counsel firm management. They can serve as “translators” in situations where cultural differences are significant. Surprisingly, in acquisitions made in culturally similar countries, the presence of directors with more directorships in other firms did not help enhance shareholder returns. One plausible explanation for this result is the busyness hypothesis where directors with multiple board appointments become too preoccupied and spread too thin. When faced with providing guidance to management in making cross-border acquisitions within similar culture countries, busy directors can inappropriately generalize their knowledge gained from past acquisitions in similar cultural context, without taking into account other complexities that come with a cross-border acquisition. Such over generalization can become costly to firm value as shown by

Haleblian and Finkelstein (1999) in their study of the effects of organizational acquisition experience on domestic acquisition performance.

I also find that, in the context of firms with existing operations in the target country, tenure among outside directors is particularly more valuable. By increasing the frequency by which target country specific assets may be deployed whenever more acquisitions in the same host country is undertaken, transaction costs may be reduced and overall acquisition shareholder performance improved. Tenured outside directors can couple their knowledge of the external environment and other markets (by virtue of being outsiders) with their knowledge of internal firm operations (from their years on the board and relationships with firm management) and become a valuable resource in finding synergies from existing operations in the target country when implementing further cross-border acquisitions.

Similar to the argument earlier, I also hypothesized that when board characteristics, such as outside director tenure, facilitate the frequency in deployments of specific assets based on extensive knowledge from past foreign acquisition experience, it would lead to improved performance from reduced transaction costs. However, my findings suggest otherwise; they imply that greater shareholder value may be realized by firms with more tenured outside directors when they have limited acquisition experience. But when I further differentiate between foreign acquisition experience and operating experience in the target country as two different sets of knowledge-based assets, the contrary results may not be entirely surprising. Unlike operational experience gained from having existing presence in a target country which is closely tied to core capabilities of the firm and generate economies of scope with each additional acquisition (within the same target country), acquisition experience is not a core-related capability and may not derive similar economies of scope benefits from each additional transaction. Nevertheless, tenured outside directors can still unlock value creation for acquiring firms with limited acquisition experience because from a TCE perspective, such directors are in

a position to lower transaction costs, thereby contributing to increased returns. From a resource dependence perspective, an outside director with high tenure can bring in acquisition related experience from prior acquisitions they might have been involved in (from their full-time job in their firm) to counsel and provide guidance to a firm with limited foreign acquisition experience. Such value-enhancing insights are likely to be welcomed by firm management with whom he/she has built a relationship through years on the board.

Another unexpected result involves the contingency effects of host country political risk on the relationship between outside director tenure and long-term shareholder value creation in foreign acquisitions. As previously argued, outside directors with significant tenure in their positions possess a combination of external expertise and internal firm knowledge. In the context of acquisitions in high political risk countries that may be instrumental in reducing transaction costs and thereby contribute to superior shareholder returns. However, my findings indicate acquisitions made in countries with low political risk benefit more from outside directors with greater tenure than those made in more politically risky countries. The results might be reflective of the fact that the stability associated with low political risk countries provides outside directors with longer tenures greater opportunities to apply their extensive market and firm knowledge in assisting managers in their undertaking of foreign acquisitions.

My findings also indicate that the effects of CEO influence on bidding firm acquisition related returns are more pronounced when acquiring firms enter markets characterized by greater political risks. From a “unity of command” perspective, having an influential CEO translates into more focused leadership which may be important in environments that demand quick resolution of problems and challenges associated with high political risk.

The results in the context of control variables in the model provide some interesting insights on the determinants of long-term shareholder value. Study findings suggest that acquisitions by firms in the manufacturing sector outperform those in the service sector. This is

intuitive because expropriation of services by acquiring firms into a different country can become more challenging considering service industry firms are more sensitive to country-specific factors such as national culture. As such, economies of scale may not be easily realizable for service firms when compared to manufacturing firms. Moreover, the “people factor” is more important in service industry firms and this poses greater post acquisition assimilation challenges as well. This study also indicates that differences in national governance systems between the target firm country and the U.S. is associated with high shareholder returns. This might be due to the fact that weak national governance regimes present in target firm countries can result in agency problems in target which might depresses their market value. This provides an opportunity to the acquiring firm to capture value by putting in place corrective mechanisms in the post-acquisition phase. (Seth, et al., 2002). Our findings are consistent with those of Freund, et al. (2007) who also found that acquisitions in host countries with greater shareholder protection resulted in lower short-term abnormal returns for acquiring firms and Chakrabarti et al. (2009) who found a positive, albeit marginal relationship, between national governance difference and the shareholder wealth created in the three years following an acquisition. To some extent, our result is also consistent with the finding of Bris, Brisley, and Cabolis (2003) that performance, measured by Tobin’s q , within an industry, improves significantly when member firms are acquired by foreign firms from a country with a stronger national governance culture.

Finally, cultural distance, in my study, had a negative effect on long-term shareholder value creation, a finding that is consistent with that in the study by Datta and Puia (1995). They lend credence to the theory that cultural fit plays a key role in cross-border acquisitions. Cultural differences, which can result in an inadequate understanding of a foreign market and the target firm, can also result in an acquiring firm overpaying for an acquisition. In addition, as previously discussed, the existence of significant cultural differences can be viewed as a factor that significantly increases -acquisition administrative and consolidation problems. As Kogut and

Singh (1988) argue, "due to the difficulty of integrating an already existing foreign management, cultural differences are likely to be especially important" (p. 414).

6.2 Research Contributions

This study addressed the fundamental question of whether bidding firms create value for their shareholders when they acquire targets in foreign markets in the year following the acquisition. More importantly, it examines how such returns are impacted by the governance structures in place in acquiring firms. The role of governance in influencing value creation among acquiring firm is an issue that has not been extensively investigated in prior research (Mitchell & Stafford, 2000). Yet, as the extensive literature on corporate governance indicates, governance structures have an important impact not only on strategic choice but also in terms of the outcomes associated with such strategies. The limited examination of the effect of governance in cross-border acquisitions had been conducted in the context of national governance related to the level of shareholder protection, via laws and their enforcement (La Porta et al., 1998). This study, therefore, makes an important theoretical and empirical contribution by developing theoretical arguments on why board characteristics and ownership structures should influence value creation in cross-border acquisitions and examining associated hypotheses in the context of 453 cross border acquisitions undertaken by U.S. firms between 1990 and 2006. More specifically, it explores how governance structures related to monitoring help mitigate agency costs towards enhancing shareholder returns. In addition, this study examines the role of incentives in the form of ownership in motivating managers and directors alike to act in the best interests of shareholders by emphasizing actions that improve shareholder returns.

While much of the prior research on cross-border acquisitions is based on the implicit assumption that economic motives underlie managers' decisions to undertake such transactions, in this study I argue that the personal interests and motivations of managers also play an important role in the making of acquisition decisions and their eventual success. By

using agency theory and resource dependency arguments to predict the effects of corporate governance on shareholder wealth, this study takes a step back and questions whether the motives of managers when acquiring other firms abroad are indeed driven by an (a) economic desire to maximize shareholder, (b) by a self-serving desire to further their own interests or (c) a combination of both. Recent studies by Datta et al. (2009) and Musteen et al. (2010) have demonstrated that managerial motives can veer from purely economic considerations in decisions involving foreign market entry. In a similar vein, my study also indicates that such non-economic considerations have a significant influence on returns in international acquisitions. This, for example, is borne out in findings which indicate that equity ownership in the firm by outside and inside directors results in superior returns, a reflection of closer alignment of their interests and motivations with those of shareholders..

My findings are also supportive of arguments based on other theoretical perspectives. This fact is not surprising given the uniqueness of cross-border acquisitions in terms of scope and the significant challenges they are associated with. For example, while agency theory arguments suggest that the extent of tenure among outside directors should be negatively related to acquisition performance; however, my results suggest otherwise. This suggests that long tenured outside directors are not necessarily a liability as agency theory would lead us to believe, but that significant tenure represents a valuable resource in the form of guidance and counsel. In other words, arguments based on a resource dependency perspective explain some of the phenomenon observed in acquisitions. While long tenures among directors may be equated with less monitoring and vigilance (consequence of management friendliness), it also implies greater access to important external and internal information necessary in the undertaking of effective cross-border acquisitions. Similarly, the presence of larger boards, often seen as being less desirable because of unproductive group dynamics by agency theorists (e.g., Jensen, 1993; Lipton & Lorsch, 1992), has a positive effect on returns from international acquisitions. A likely explanation for the same lies in the complexities associated

with acquisitions in the international context, with a larger board providing the resources (especially in the form of information and knowledge) and resulting in successful acquisitions. In other words, the benefits of large boards as resource providers outweigh the drawbacks linked to unproductive group dynamics. Moreover, while agency theory arguments would lead us to believe that CEOs with greater influence and power are likely to engage in self-serving behavior that further their own interests, my results seem to support a stewardship perspective. While an influential CEO may be in a position to further his/her own interests, they are generally very mindful of the interests of their key stakeholders in the decisions that they make. The positive association between CEO influence and shareholder returns in my results might also be reflective of situations where influential CEOs recognize that weak performance endangers their own power and influence and, consequently, strive to attain the highest possible returns from their international acquisitions.

The other main contribution of my study relates to the findings that the effects of governance characteristics are not uniform across different contextual conditions. As my results indicate, the effect varies with the effects being more/less pronounced under some environmental and firm conditions. The contingency relationships uncovered in my study provide a richer picture of how governance attributes play a key role in unlocking value in cross-border acquisitions. Extant literature has typically viewed some of these variables as having a direct effect on value creation in acquisitions; however my results indicate they also represent conditions under which key governance attributes have a pronounced impact on value creation.

From a methodological perspective, this study represents one of the very few in strategic management and international business to assess acquisition returns over a longer time frame using the BHAR (buy-and-hold abnormal returns) methodology. Most studies to date have examined wealth effects around relatively short-term windows surrounding the announcement date. However, it can be argued that value creation in foreign acquisitions is best assessed over longer time frames than what the traditional event study methodology

allows. The benefit of using the BHAR methodology are twofold: first, as emphasized by Lyon et al. (1999), this approach has the ability to yield an abnormal return measure that more accurately represents investor experience when compared to cumulative abnormal returns over longer windows using the market model. Second, with the recent advances and refinements that have been developed the BHAR methodology, it is possible to for several sources of misspecification such as new listing, rebalancing, and skewness biases in the assessment of long-term market effects. Taking into consideration that it takes more time for a cross-border acquisition to become operational and create value, a more extended look on the market effects of such endeavors become more relevant. Indeed, I see the BHAR methodology as having significant potential in the study of market performance of strategic decisions in the strategy and international business fields (e.g., international diversification, strategic alliances and greenfield investments). Most such decisions are characterized by high levels of uncertainty and how such decisions are implemented has an important bearing on performance as the decision itself.

6.3 Implications for Managerial Practice

As my findings indicate, foreign acquisitions, on average, do not result in significant positive long-term returns. However, a combination of governance mechanisms can have an important impact on such returns. While governance watchdog agencies have pleaded to limit board size and director tenure, my results indicate that larger boards and longer tenured outside directors can indeed be beneficial from the standpoint of value creation in cross-border acquisitions. As such, having close to the optimal board size and director tenure is important in generating higher returns in foreign acquisitions. CEO influence, as it turns out, also does not necessarily imply weak governance as agency theorists tend to argue. My findings indicate that CEOs with influence have a beneficial impact on shareholder value resulting from international acquisitions. In other words, firms are unlikely to benefit from efforts at curbing the influence of CEOs. CEOs who wield greater influence are also instrumental in providing the vision and direction that an acquiring firm needs as it negotiates the challenges associated with

acquisitions in international markets. However, from the standpoint of managerial practice our results highlight the important role of firm equity ownership by inside and outside directors. Firms interested in acquisitions are likely to benefit from having their directors own shares in the firms – doing so will motivate them to focus on shareholder value creation rather than their own interests. In sum, my study findings should educate managers and directors on the importance of corporate governance in ensuring that firm strategies (including, cross-border acquisitions) result in desired outcomes.

Another important message for managers on the importance of governance factors is that one size does not fit all. In other words, the impact of specific governance mechanisms is contingent on the environmental and the organizational context. For example, while there are benefits to having a larger board, the benefits are more pronounced when acquisitions are made in rapidly growing economies characterized by more complex and dynamic environments. Additionally, with more firms seeking to enter countries characterized by higher levels of political risk, my findings indicate that firms are likely to be better off having CEOs who have greater influence and power (i.e., unity in command is important). In addition, it seems that firms making acquisitions in attractive markets characterized by lower political risks and stable business climates benefit from having outside directors with longer tenure. Their experience and knowledge in facilitating value creation in cross-border acquisitions seem to be most applicable in such markets. Likewise, when making acquisitions in culturally distant countries, firms are likely to benefit from larger boards and having directors whose reputation and competence enables them to provide firms with the counsel that is vital to success of the acquisitions they undertake. In addition, my findings have an important message for firms with limited acquisition experience. They are very likely to benefit from having directors on the board with longer tenures and who can use their expertise and knowledge to overcome the limitations posed by the lack in international acquisition experience.

6.4 Study Limitations and Future Research Directions

This study, like any other, is not without its limitations. For one, the sample was restricted to U.S. acquiring firms which makes it difficult to generalize the findings to acquiring firms of other countries. However, given a smaller number of cross-border acquisitions made by firms in other countries, along with data non-availability, using the methodology utilized in my study (involving benchmark portfolios of similar firms) becomes particularly challenging. Perhaps, the use of a country-market benchmark as in Chakrabarti et al. (2009) might represent a possible solution but the results are unlikely to be comparable. Given data constraints, future research using a slightly different methodology (but with similar intent) can probably be conducted to test for comparability of results across various countries. Indeed research that focuses on the role of governance in acquisitions by firms in other countries, including those from emerging markets, should help improve our understanding the impact of governance structures in different institutional environments.

Another limitation of this study relates to the cross-sectional nature of the study. It may be argued that governance structures may change as a result of an acquisition, thereby raising the question on whether returns in the post-acquisition phase are impacted by the governance structures prevalent prior to the acquisition. However, because of the use of staggered boards, it is very unlikely that firm governance mechanisms will change radically within a year of the completion of an acquisition (the time frame over which I assessed the wealth effects). However, that may be more of an issue if longer (e.g., 3 year) time periods are used. Future research that can measure the governance characteristics of acquiring firms before and after the acquisition can provide a more dynamic picture of the role of governance in international acquisitions. Future research may also explore the possibility of different governance mechanisms having different effects at different points in time. For example, one can possibly argue that the effects of governance will be more pronounced in the year after the acquisition but becomes less important in the following years.

Additionally, the relatively crude measure used for director reputation may have contributed to the non-significant direct effects associated with the variable. Future studies looking into a similar relationship may adopt more fine-grained measures, one that also incorporates measures of the reputation of the firms on whose boards they serve. Also, it might be useful to explore alternative classifications of institutional ownership in the assessment of the impact of such ownership. This might include the classification scheme developed by Kochhar and David (1998) wherein institutional shareholders are classified as pressure-resistant, pressure-sensitive, and pressure-neutral. Finally, the finding on the effect of outside director tenure is interesting considering there has been a clear demarcation with the expertise hypothesis explaining the positive effects and managerial friendliness the negative effects (Vafeas, 2003). Future research can also address whether these effects are complementary rather than competitive, as is often assumed. My study found the direct and contingency effects for board size and outside director tenure indicate the importance of having a larger, experienced board who, in addition to external market expertise also have knowledge about the internal operations of the firm.

6.5 Conclusions

The literature on the performance of cross-border acquisitions indicates that ownership of valuable resources, the choice of location where this asset is to be exploited and certain transaction characteristics are central to value creation in such acquisitions. However, along with the question of whether firms with the necessary resources or capabilities gain from foreign acquisitions, it is important to examine whether they have the requisite governance mechanisms in place to facilitate superior performance outcomes. This study demonstrates that certain governance factors play an important role in ensuring that acquisitions generate shareholder value from the standpoint of bidding firms in cross-border acquisitions. In other words, my findings suggest that before firms invest millions (or, often, billions) of dollars in the undertaking of such transactions, a careful assessment of the appropriateness of existing governance

structures in the context of the acquisition should be undertaken. Doing so could result in enhanced probabilities of success and greater shareholder value created in such transactions.

In conclusion, while this study provides interesting insights into how governance structures influence value creation in the context of cross-border acquisitions, it also raises some important questions. When addressed in future research they can further contribute to our understanding of such acquisitions. Clearly, there are several intriguing but unanswered questions on how governance mechanisms influence managerial behavior and strategic choices in the international context. Much work remains and I hope that this study stimulates further work in this regard.

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BIOGRAPHICAL INFORMATION

Dynah was born and raised in the Philippines, where she finished her bachelor's degree in Business Administration at the University of the Philippines in Diliman. She went on to get her MBA at the University of Texas at Dallas and her MS in Telecoms Management at Oklahoma State University. After working in the finance and telecommunications industries in various capacities (such as sales, marketing, and R&D finance) and in different countries (Philippines, U.S., and Hong Kong) for almost a decade, she moved to Mexico and began a career in the academe. Her exposure to teaching, of almost 5 years, led her back to Dallas, this time to the University of Texas at Arlington, to pursue her PhD. As a graduate student, she had works presented at the Academy of Management meetings and published a book chapter and an article in the Journal of Management on the topic of employee downsizing.