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Applied Mergers and Acquisitions

ROBERT F. BRUNER

WILEY

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Cross-Border M&A

INTRODUCTION

This chapter explores the special M&A perspectives where the buyer and target firm are in different countries. This complements several chapters as the cross-border deal raises especially difficult questions about strategy, valuation, deal design, and implementation. The M&A practitioner should master the perspective of cross-border deals because they:

- ***Are significant.*** The volume of cross-border M&A activity is large, whether judged in terms of number of deals or value. The formation of trade blocs and regional associations hastens the growth in volume. And the volume of activity is likely to get bigger as country and regional markets integrate into the global market.
- ***Can be disruptive.*** In many countries and regions, cross-border M&A activity produces big surprises in the form of unanticipated entry by buyers, higher purchase prices, and changes in strategic assumptions about a local market.
- ***Can be motivated by a range of factors, different from domestic deals.*** These factors include growth by market expansion, extension of technology and brands, acquisition of special resources, tax and currency arbitrage, and the benefits of international diversification. This chapter will outline a number of these motives and summarize research on their effects.
- ***Entail a fundamental bet on countries.*** Countries differ in important ways that will affect the values of firms. Beneath every cross-border valuation analysis is some hidden assumption or bet about the future of a country market. Since 1945, local product and financial markets have trended toward greater integration with global markets. Integration brings with it economic benefits as well as costs to the local markets and institutions. One should have a view about the direction and pace of integration within home and foreign countries. This chapter will sketch some steps for country analysis.
- ***Affect analysis.*** It is a mistake to think that cross-border M&A is like domestic M&A, but with different-looking currency. In fact, going across borders requires adjustments in the valuation frameworks and analysis that one takes for granted in assessing domestic deals. Necessary adjustments in cash flows and discount rates can change the conclusions about a deal dramatically. Chapter 13 discusses the special adjustments for valuation across borders.

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CROSS-BORDER M&A ACTIVITY

The volume of cross-border M&A transactions has risen to record levels in recent years. Exhibit 5.1 presents the trends of transactions involving a U.S.-based buyer or target:

- *Number of deals.* Columns 1, 2, and 3 show that the volume of transactions by number of deals more than doubled from 1991 to 2000—and then fell to half by 2002. Classifying by whether the deal was "inbound" (i.e., where a U.S. firm was the target) or "outbound" (i.e., where a U.S. firm was the buyer) reveals that the biggest growth in the 1990s occurred in the number of outbound deals.
- *Dollar value of deals.* Columns 4, 5, and 6 show huge increases in the dollar value of cross-border deals. In all years but two, the value of inbound deals has been greater than outbound deals (i.e., reversing the observation based on number of deals). Comparing the data on number of deals and value of deals, it appears that U.S. buyers have bought a larger number of smaller foreign targets, while foreign buyers have bought a smaller number of larger U.S. targets.
- *Cross-border volume relative to total M&A volume.* Columns 7 and 8 present the percentage of cross-border deals relative to total amounts for U.S.-based deal volume. The cross-border number of deals represents between 17.6 and 25 percent of the total. And comparing the dollar volumes with the total inbound and outbound foreign direct investment (FDI) in the United States, M&A volume accounts for the bulk of FDI.[1]

Looking beyond the confines of U.S.-related deals, the United Nations Conference on Trade and Development (UNCTAD) estimates that cross-border acquisition is the largest medium of foreign direct investment, accounting for 55 to 60 percent of the totals.[2] The volume of cross-border M&A is even larger if one considers other kinds of corporate transactions (e.g., joint ventures and project financings) possibly as partial or creeping acquisitions.[3] However, by any measure, cross-border M&A is sizable, and is a material element of all (i.e., domestic and cross-border) M&A activity.

Cross-border transactions have a different profile compared to domestic deals. Researchers have found that cross-border deals are:

- *More related.* Cross-border acquisitions tend not to represent diversification far beyond the buyer's core industry. Acquisitions into related businesses represent 60 to 75 percent of cross-border deals.[4]
- *Payment is mainly in cash.* Many cross-border buyers do not have shares listed for trading in the foreign market. Therefore, it is not surprising that buyers tend to pay with cash rather than stock.[5]
- *Targets are mainly manufacturing firms with low intangible assets.* Conn and Nielsen (1990) found that 97 percent of U.S. firms' targets and 74 percent of U.K. firms' targets were in manufacturing rather than finance or services.

EXHIBIT 5.1 Trends in Completed Cross-Border Mergers and Acquisitions Involving a U.S.-based Buyer or Target

Column	1	2	3	4	5	6	7	8	9	10
	Number of Cross-Border Deals			Value of Cross-Border Deals			Cross-Border Deals as a Percentage of All Transactions (Domestic and Cross-Border)		Value of All Foreign Direct Investment into and out from the United States	
	Total Number	Number of Inbound Deals	Number of Outbound Deals	Total Value (Billions)	Value of Inbound (Billions)	Value of Outbound (Billions)	% of Number of Deals	% of Total Value	Inbound U.S. FDI (Billions)	Outbound U.S. FDI (Billions)
2002	1,489	649	840	$107.0	$ 65.0	$ 42.0	17.6%	10.8%	$ 39.6	$137.8
2001	2,063	888	1,175	$216.0	$118.4	$ 97.6	20.3%	14.3%	$157.9	$156.0
2000	3,259	1,391	1,868	$433.8	$311.5	$122.3	24.0%	13.7%	$287.7	$152.4
1999	2,701	1,059	1,642	$349.9	$229.9	$120.0	25.0%	23.2%	$282.5	$155.2
1998	2,630	884	1,746	$320.3	$191.8	$128.6	21.9%	22.2%	$193.4	$132.8
1997	2,205	790	1,415	$143.8	$ 70.7	$ 73.1	20.7%	17.9%	$109.3	$109.8
1996	1,952	689	1,263	$121.2	$ 65.2	$ 56.0	19.8%	17.6%	$ 89.0	$ 92.7
1995	1,746	619	1,127	$ 83.2	$ 42.0	$ 41.1	19.9%	17.8%	$ 59.6	$ 99.5
1994	1,415	555	860	$ 60.6	$ 39.0	$ 21.6	19.7%	19.4%	$ 47.4	$ 80.7
1993	1,140	428	712	$ 33.2	$ 16.6	$ 16.6	19.5%	16.4%	$ 52.6	$ 84.4
1992	1,033	431	602	$ 28.3	$ 13.4	$ 14.9	19.5%	19.8%	$ 21.0	$ 48.7
1991	1,152	592	560	$ 42.1	$ 27.6	$ 14.5	23.0%	27.0%	$ 23.7	$ 38.2

Sources of data: Thomson Financial Securities Data and Bureau of Economic Analysis, U.S. Department of Commerce.

Notes:

- The foreign direct investment values in column 9 include only capital flows sourced from foreign markets. Funds sourced from the U.S. capital markets for acquisitions or investments made by foreign companies are not included. Hence, the comparison between column 5 and 9 is not perfect. Column 5 includes all sources of funding, domestic and abroad. Column 9 only includes foreign capital that "flowed in." A similar incomparability exists for columns 6 and 10.
- Despite the imperfect comparison between cross-border value and FDI, an analyst at the Bureau of Economic Analysis confirms that the majority of capital flowing into the United States for FDI in recent years has been for acquisitions. The analyst estimated the fraction to be between 60% and 80%.

M&A ACTIVITY WITHIN REGIONS AND TRADING BLOCS

Viewed from a global perspective, the most interesting laboratories for M&A today are the new *trading blocs* such as NAFTA and the European Monetary Union (EMU, or "Euroland").[6] The reason for this is that free trade changes the rules of competition by reducing entry barriers, making it easier to exploit economies of scale, increasing capital market integration (which improves capital flows and lowers the cost of capital), improving the transfer of technology and intellectual capital, and reducing the idiosyncrasies of government regulation and tax policies. These changes, in turn, will affect M&A activity. Most observers expect product market competition within trading blocs to increase thanks to greater transparency about product and factor prices within the blocs. For instance, with product prices denominated in the same units across Euroland, the more efficient producers are motivated to enter new markets and compete on price. In this context, M&A is used as both a defensive and an offensive tactic. The history of M&A in the United States offers abundant evidence that M&A waves are significantly driven by product market changes. Capital markets are likely to integrate more rapidly within trading blocs, making M&A financing cheaper, easier to obtain, and available in forms that are tailored more readily to the needs of M&A participants. We know that the level of capital costs and the availability of financing significantly influence M&A activity. Sleuwagen (1998) found that over the period 1994–1996, about 60 percent of all mergers and acquisitions in the EU involved firms located in the same member state. Pointing to the experience with NAFTA, many analysts believed that with the advent of the euro, the percentage of same-country mergers would decline and cross-border deals would rise.

Exhibit 5.2 shows the percentage change in cross-border acquisitions among the United States, Canada, and Mexico from 1991 to 1993, before NAFTA was formed, to 1994–1997, the three years following NAFTA. Within the United States, the number of U.S./U.S. acquisitions grew 60 percent, reflecting the onset of the largest acquisition wave in U.S. history; this domestic growth rate is a rough bench-

EXHIBIT 5.2 Percentage Rate of Growth in Transactions Domestically and Cross-Border among the United States, Mexico, and Canada, Comparing Deal Volumes from 1991–1993 to 1994–1996

	Country of Acquirer		
Country of Target	United States	Canada	Mexico
United States	60%	65%	38%
Canada	70%		
Mexico	44%	70%	

Note: The growth rate is calculated by dividing the number of all transactions 1991–1993 into the number of all transactions 1994–1996, and subtracting 1.0.

Source: Thomson Financial Securities Data Corporation, Mergers and Acquisitions Database.

mark for comparing cross-border M&A growth rates within NAFTA. The exhibit shows that acquisitions by U.S. firms into Canada and by Canadian firms into the United States outpaced the domestic U.S. acquisition growth rate. The results with respect to Mexico are significantly lower than the U.S. domestic deal growth, reflecting perhaps the massive devaluation of the peso in 1995 and offering a caution to executives.

Increasing capital market integration elevates the importance of the equity investor mind-set probably at the expense of other stakeholders. As the equity orientation grows, M&A practice changes. Overpayment is penalized; price becomes an object of greater attention. The volume of unsolicited acquisition attempts may rise. The product market scenario outlined earlier may place special importance on the advantage of the "first mover." To enter new markets rapidly, decisively, and first may dictate tactics that are at their core impatient. The unsolicited acquisition attempt is risky, but may be justified in managers' minds by the circumstances. Before the euro, the hostile tender offer was a rarity in Europe. But the weeks following the birth of the euro witnessed major hostile offers on the continent.[7] Deal structures following increased capital market integration may also reflect greater use of innovative terms including derivative securities, bridge loans, and "junk" debt. Growing sophistication in the capital markets will make this possible.

Acquisitions are inherently acts of optimism. Deteriorating economic conditions would likely impair that optimism, and the resulting volume of deals. Again, the experience of Mexico/U.S. cross-border deals is illustrative here. Exhibit 5.3 shows that Mexican acquirers virtually disappeared from the cross-border M&A market in the wake of the peso devaluation in late 1994. The financial crisis in East Asia in 1997 triggered a wave of M&A activity in that region. Precrisis in 1996, the regional volume of deals was $3 billion per year. In 1999, the volume had risen to $22 billion; this stemmed significantly from M&A activity in Korea and Thailand, two countries deeply affected by the "Asian flu" crisis. Especially strong activity was seen in real estate, financial services, retailing, and wholesaling. Mody and Negishi (2001) argued that driving the increased M&A was a general rise in inbound foreign direct investment associated with economic restructuring of the region after the crisis. Further, they argue that the M&A activity was driven by the creation of new opportunities due to government policy changes in the region than by the lure of bargain-basement asset prices.

EXHIBIT 5.3 Cross-Border Transactions between Mexico and the United States, 1994 and 1995

	1994	1995	% Change
Acquisitions by U.S. firms into Mexico			
Number of transactions	48	47	–2.1%
Value (US$ millions)	$496	$499	0.7%
Acquisitions by Mexican firms in the U.S.			
Number of transactions	14	1	–92.9%
Value (US$ millions)	$2,094	$0.1	–100.0%

Source of data: Thomson Financial Securities Data Corporation, Mergers and Acquisitions Database.

DRIVERS OF CROSS-BORDER M&A

A large body of research illuminates the forces behind cross-border M&A activity: exploiting market imperfections, intangible assets, risk reduction through diversification, exchange rates, financial market conditions, and tax rates.

Exploit Market Imperfections

A venerable stream of research in economics suggests that foreign direct investment through cross-border acquisition seeks to take advantage of market imperfections and failures[8] in foreign countries. The theory is that the buyer will recognize profitable opportunities to take advantage of cheap labor and raw materials, unmet consumer demand, deregulation, trade liberalization, and country integration of capital and product markets into global markets. Exhibit 5.4 presents a list of 17 large cross-border deals from 1997 to 2002. The forces of change are evident in the makeup of this list:

- *Telecommunications.* Seven of the 17 deals originate in the telecommunications industry and suggest these forces at work: rapid technological change and government deregulation. Vodafone/Mannesmann and Vodafone/AirTouch, both in the wireless segment of the industry, are notable for their size. Also, Vodafone initiated one of the few hostile offers ever to occur in Germany—and won.
- *Pharmaceuticals/chemicals.* Rising R&D expense and the desire to achieve distribution economies motivated the Astra/Zeneca and Hoechst/Rhône-Poulenc deals.
- *Consumer foods.* Two deals (acquisitions of BestFoods and BAT Industries) were driven by the desire for portfolio diversification across product categories, perceived benefits of global branding, perceived undervaluation of brands in the home capital markets, and an expectation of greater economies of scale in distribution.
- *Automobiles.* Rising new product development costs and the consequent consolidation in the industry motivated the combinations of Daimler/Chrysler, Ford/Volvo, and others.

In short, the surging volume in cross-border M&A is driven by the many of the same fundamental economic forces outlined in Chapter 4. From this perspective, cross-border M&A activity is not a curious sideshow to the large domestic U.S. volume, but is sizable and linked integrally with it.

Extend the Reach of the Buyer's or Target's Intangible Assets

Researchers[9] observe the heavier investment in manufacturing and speculate that cross-border M&A represents an effort of firms with significant intangible assets (such as brand names, patents, and managerial know-how) to broaden the scale of their use and preempt others who might be tempted to imitate or appropriate those intangible assets. Similarly, a foreign buyer may seek to acquire intangible assets of a foreign target with the intent of bringing the benefits of those assets back home. Eun et al. (1996) found that foreign acquirers benefit from targets' R&D. Morck and Yeung (1991) found that "the positive impact of spending for research and development

EXHIBIT 5.4 Seventeen Largest Cross-Border Deals, 1997–2002

Date Announced	Target Name	Target Nation	Acquirer Name	Acquirer Nation	Transaction Value ($ Millions)	Enterprise Value ($ Millions)	Equity Value ($ Millions)	Asset Value ($ Millions)
11/14/99	Mannesmann AG	Germany	Vodafone AirTouch PLC	U.K.	202,785	180,033	179,861	21,442
4/18/99	Telecom Italia SpA	Italy	Deutsche Telekom AG	Germany	81,528	74,613	66,801	52,744
1/18/99	AirTouch Communications	U.S.	Vodafone Group PLC	U.K.	60,287	65,770	60,212	17,262
8/11/98	Amoco Corp.	U.S.	British Petroleum Co. PLC	U.K.	48,174	54,768	47,902	32,274
5/30/00	Orange PLC (Mannesmann AG)	U.K.	France Telecom SA	France	45,967	N/A	N/A	2,901
5/17/99	US WEST Inc.	U.S.	Global Crossing Ltd.	Bermuda	41,105	51,097	41,098	18,709
5/7/98	Chrysler Corp.	U.S.	Daimler-Benz AG	Germany	40,467	49,377	40,467	64,256
6/20/00	Seagram Co. Ltd.	Canada	Vivendi SA	France	40,428	38,725	29,771	34,921
12/9/98	Astra AB	Sweden	Zeneca Group PLC	U.K.	34,637	31,787	34,637	7,841
10/21/99	Orange PLC	U.K.	Mannesmann AG	Germany	32,595	34,214	31,489	2,901
4/1/99	ARCO	U.S.	BP Amoco PLC	U.K.	27,224	33,702	27,224	25,199
5/2/00	Bestfoods	U.S.	Unilever PLC	U.K.	25,065	23,529	20,895	6,209
5/17/99	Hoechst AG	Germany	Rhone-Poulenc SA	France	21,918	28,526	21,917	33,338
11/16/98	Rhône-Poulenc SA—Life Sciences	France	Hoechst AG—Life Sciences Divs.	Germany	21,223	N/A	N/A	N/A
4/17/00	Allied Zurich PLC	U.K.	Zurich Allied AG	Switzerland	19,399	21,409	19,384	87,552
11/1/96	MCI Communications Corp.	U.S.	British Telecom PLC	U.K.	18,889	27,272	23,328	19,301
10/13/97	BAT Industries PLC-Financial	U.K.	Zurich Versicherungs GmbH	Switzerland	18,355	N/A	N/A	N/A

Note: Size judged on the basis of transaction value in millions of U.S. dollars.
Source: Thomson Securities Data Corporation, Mergers and Acquisitions Database.

and for advertising on market value increases with a firm's multinational scale, but that multinationality per se does not have any significant impact. . . . Intangible assets are necessary for direct foreign investment to make sense." (Page 185)

Reduce Tax Expense through Arbitrage across Different Tax Jurisdictions

Marginal corporate tax rates vary dramatically across the globe. In January 2002, they ranged from a low of 16 percent in Hong Kong and Chile to a high of 42 percent in Sri Lanka with a mean of 31.39 percent for OECD countries (see KMPG (2002)). Some have argued that this disparity permits multinational corporations to shift operations globally in ways that profitably arbitrages away from high-tax jurisdictions and toward lower-tax jurisdictions.[10] This is consistent with anecdotal evidence from practitioners (especially chief financial officers) about the importance of tax considerations in investment decisions. Nevertheless, empirical research at best gives mixed support for this motive.[11]

Reduce Risk through Diversification

If economic activity across countries is less than perfectly correlated, geographic diversification can reduce risk. This is a straightforward extension of modern portfolio theory. For instance, Adler and Dumas (1975) argued that international diversification pays when capital markets are not fully integrated. Whereas correlations among stock returns within a country can be high, correlations across countries are highly variable, and can be quite low or even negative. Exhibit 5.5 presents equity market correlations between the United States and various emerging markets countries. Rouwenhorst (1999) reported that from 1970 to 1998 the average correlation between index returns in Japan and the United States was 25 percent; between the United Kingdom and United States, it was 50 percent. Explanations for such variability across countries could be differing degrees of economic development and integration with global markets.[12]

Even though local market volatilities might be high, a low correlation with that market might make it attractive to invest there. This is the chief argument in favor

EXHIBIT 5.5 Emerging Market Correlations with U.S. Market

	1976–1985	1985–1992	1995–1999
Argentina	3%	10%	52%
Brazil	–7%	13%	48%
Chile	–11%	32%	46%
Mexico	13%	49%	60%
Thailand	–9%	43%	53%

Source of data: Standard & Poor's/International Finance Corporation, "The S&P Emerging Market Indices: Methodologies, Definitions, and Practices," February 2000, page 32.

of global diversification of equity investing. Madura and Whyte (1990) argued that "differences in characteristics between real assets and financial assets can cause different degrees of diversification benefits. For example, real sectors can cause different degrees of diversification than foreign financial sectors will offer greater potential diversification benefits *if* those sectors can be penetrated." (Page 75) But does this translate into benefits for shareholders at the level of corporate investing? Some evidence suggests that the share prices of multinational corporations (MNCs) reflect well the geographic diversification, while other studies suggest that MNCs do not provide all the benefits of direct investment in foreign securities.[13] Fatemi (1984) compared MNCs with purely domestic firms, and found that returns on MNCs fluctuate less than domestic firms, that the betas of MNCs are more stable than domestic firms. Thus, risk reduction through geographical diversification seems to work. Fatemi also reported that risk-adjusted abnormal returns for MNCs are similar to domestic firms. Mikhail and Shawky (1979) and Errunza and Senbet (1981) found that the degree of international presence has a positive effect on excess returns. Doukas and Travlos (1988) reported that investor reaction to news of entry into a new foreign market is positive and significant, and most pronounced when the entry is into an emerging market country.

Is risk reduced more effectively by diversifying across countries or across global industries?[14] Until the mid-1990s, low correlations among countries' stock markets led to the conventional wisdom that much of the variability in returns from global investing stemmed from country choice. Marber (1998, p. 172) reported the findings of Barr Rosenberg Associates and the International Finance Corporation (IFC), who studied the extent to which choices about country, industry, and specific firm explained cross-sectional variation in global equity returns. They estimated the percent of returns variance explained by country, industry, and *stock-specific factors* for investments in developed markets and emerging markets. The results of the study, summarized in Exhibit 5.6, are that *industry factors* are dominant in developed countries and *country factors* are dominant in emerging countries. Other studies[15] show that country choices are very important, if not the most important, drivers of returns performance. Solnik (1991, p. 360) reported a study by Frank Russell Company of investment activities of international managers, finding that on average the manager puts 50 percent of resources into country analysis, 15 percent into industry analysis, and 35 percent into company analysis. But recent research has suggested that growing integration of the global equity market and the rising

EXHIBIT 5.6 Factors Explaining Equity Returns in Emerging and Developed Markets

	Investments in Emerging Markets	Investments in Developed Markets
Stock-specific factors	16%	22%
Industry factors	38%	48%
Country factors	46%	30%
Total	100%	100%

Source of data: Marber (1998), page 172.

multinationality of companies elevate the importance of industry and firm-specific factors. However, other research suggests that country choice remains of preeminent importance. The relative significance of industry and country persists as a debate at the frontier of empirical finance. Either way, country choice will remain a material factor for some time to come. The global M&A analyst will seek to diversify across *both* countries and industries.[16]

Exploit Differences in Capital Market and Currency Conditions

One of the most reliable findings about M&A activity in the U.S. is the strong relationship between deal doing and high stock and bond prices. In the cross-border world, a strong relationship also exists though it is complicated by the fact that it is driven by comparative differences between *two* local financial markets. Feliciano and Lipsey (2002) found that acquisitions of U.S. firms by foreign firms decline with high U.S. stock prices, high industry profitability, and high industry growth, and increase with high U.S. interest rates, high U.S. growth rates, and high foreign currencies relative to the U.S. dollar. Vasconcellos et al. (1990) found that foreign firms increase their acquisitions in the United States when U.S. economic conditions are favorable compared to the foreign country, interest rates are high in the foreign country compared to the United States, and the dollar is weak relative to the foreign currency. Gonzalez, Vasconcellos, and Kish (1998) found that undervalued U.S. companies were more likely to be targets of acquisition by foreign companies.

Closely related to capital market conditions are currency market conditions. Variation in exchange rates can render one country's firms cheaper or dearer to buyers from another country. But conventional economic analysis would reject this, arguing that in an integrated global market, real rates of return on assets will be equal across countries, preventing profitable arbitrage on the basis of currency exchange rate variations. Froot and Stein (1991) linked currency changes to the relative wealth of buyers to argue, in effect, that countries with deep financial pockets because of strong currencies will tend to originate foreign direct investment. They find a strong relationship between exchange rate movements and FDI. Harris and Ravenscraft (1991) found a strong relationship between exchange rate movements and cross-border acquisition announcement effects. Vasconcellos and Kish (1998) reported a strong relationship between acquisition activity and exchange rate movements. Vasconcellos, Madura, and Kish (1990) concluded, "In the final analysis, the long-run outlook on the dollar is the critical factor in foreign acquisition of or by U.S. firms." (Page 184)

Improve Governance

Good governance pays, a point discussed in Chapter 26. Corporate governance practices vary significantly across countries. Researchers have examined whether M&A changes in investor protection stemming from these cross-border differences influence merger outcomes. Bris and Cabolis (2002) studied the change in investor protection arising from cross-country deals. They found that the valuation multiples (Tobin's Q[17]) in the home market rise when a foreign firm buys into that industry, coming from a country with greater investor protection. Rossi and

Volpin (2001) suggest that M&A is a means by which companies can exit from a poor governance environment. Companies from countries with poorer governance practices are more likely to be acquired; those with stronger governance are more likely to buy.

Other Drivers of M&A Activity

Biswas et al. (1997) list a range of other possible motives for cross border acquisitions. These include regulatory avoidance, financing, and the desire to maintain good relationships with customers who themselves may have a need for multinational delivery of goods or services.

RETURNS FROM CROSS-BORDER M&A

Does all of this activity pay? The following points highlight the findings of 17 studies regarding the abnormal returns to shareholders at the announcement of cross-border acquisitions.

- *Returns to targets of foreign buyers.* Exhibit 5.7 shows that returns to target shareholders are significantly positive. Two studies report that U.S. targets receive materially higher returns than do foreign targets. In five studies, returns of U.S. targets are higher with foreign buyers than domestic buyers. One study, by Dewenter (1995) yields the provocative suggestion that the difference in results between U.S. and foreign buyers could be due to differences in industrial profiles of the two groups of acquisitions—much more research is required here. Cross-sectional analyses suggest that returns to targets vary significantly by country, industry, and currency rates.
- *Returns to buyers of foreign targets.* Exhibit 5.8 shows that returns to buyer shareholders are essentially zero. In four studies, U.S. buyers of foreign targets earn returns insignificantly different from zero. In 12 studies of returns to foreign buyers, one reports significantly negative returns, two report significantly positive returns, and the rest report returns insignificantly different from zero.
- *Joint wealth changes to buyers and targets.* Exhibit 5.9 summarizes three studies that report positive joint wealth gains (two of them are significant) to shareholders of buyers and targets.

The total picture appears to be that cross-border M&A *does* pay. Consistent with the findings for U.S. domestic M&A reported in Chapter 3, targets earn large returns; buyers essentially break even; and on a combined basis, shareholders gain. We are left with the general impression that foreign bidders pay more than domestic bidders. Kohers and Kohers (2001) have argued that this premium represents payment for special local knowledge and market access that the target provides the foreign buyer.

EXHIBIT 5.7 Returns to Targets of Foreign Buyers

Study	Cumulative Abnormal Returns (% or avg$/acq)	Sample Size	Sample Period	Event Window (Days)	Notes
Conn, Connell (1990)	0.1822* non-U.S. (DMM) 0.1984* non-U.S. (IMM)	73	1971–1980	−1,0	"Non-U.S." and "U.S." indicate country of target firm. "IMM" indicates returns estimated using a market model with an

EXHIBIT 5.7 Returns to Targets of Foreign Buyers

Study	Cumulative Abnormal Returns (% or avg$/acq)	Sample Size	Sample Period	Event Window (Days)	Notes
Conn, Connell (1990)	0.1822* non-U.S. (DMM)	73	1971–1980	−1,0	"Non-U.S." and "U.S." indicate country of target firm. "IMM" indicates returns estimated using a market model with an international market index. "DMM" uses a domestic market index.
	0.1984* non-U.S. (IMM)				
	0.3986* U.S. (DMM)				
	0.4331* U.S. (IMM)				
Biswas et al. (1997)	0.0623* all observations	81	1977–1987	−1,0	Focus is non-U.S. targets and financial sector deals.
	0.0350* non-U.S.	33			
	0.0752* U.S. only	48			
	0.1069* U.S. domestic	N/A			
Wansley et al. (1983)	0.3864* target of foreign buyer	39	1970–1978	−40,0	Focus is U.S. targets.
	0.2800* target of U.S. buyer	164			
	Difference is significant at 5% level.				
Shaked et al. (1991)	0.168* foreign buyer	29	1980–1983	−1,0	Focus is U.S. targets.
	0.148* domestic buyer	82			
	Difference is significant in oils, mining, and machinery.				
Harris, Ravenscraft (1991)	0.397* foreign buyers	1,273	1970–1987	−5,0	Focus is U.S. targets.
	0.263* U.S. buyers				
Marr et al. (1993)	0.1182* foreign buyers	96	1975–1987	−1,0	Focus is U.S. targets.
	0.0627* U.S. buyers				
	Difference is significant at 5% level.				
Kang (1993)	0.0907* Japanese buyers	102	1975–1988	−1,0	Focus is U.S. targets.
	0.0684 U.S. buyers				
	Difference is not significant.				

(Continued)

EXHIBIT 5.7 *(Continued)*

Study	Cumulative Abnormal Returns (% or avg$/acq)	Sample Size	Sample Period	Event Window (Days)	Notes
Pettway, Sicherman, Speiss, (1993)	0.3700†	10	1981–1991	−1,0	Focus is U.S. targets of Japanese buyers.
Servaes, Zenner (1994)	0.3802* 1979–1980 0.1520* 1981–1986 0.4161* 1987–1988	779	1979–1988	N/A	Focus is U.S. targets.
Dewenter (1995)	Domestic acquisition premium is not significantly different from foreign acquisition premium.	294	1978–1989	N/A	Focus is U.S. targets. Looked at premiums unique to two industries, chemicals and retailing. Argued that observed differences in other studies were due to industry composition of samples.
Eun, Kolodny, Scheraga (1996)	0.3702* all observations 0.3715* Canadian buyers 0.4855* Japanese buyers 0.3555* U.K. buyers 0.3530* all other buyers	213	1979–1990	−5,0	Focus is U.S. targets.
Kiymaz, Mukherjee (2000)	Strong effects of currency and relative GNP growth rates of two countries.	141	1982–1991	−1,0	Focus is U.S. targets.
Kuipers, Miller, Patel (2003)	+23.07%† $121.86 MM†	181	1982–1991	−1,0	Focus is U.S. targets.

*Significant at the 95 percent confidence level.
†Significant at the 99 percent confidence level.

EXHIBIT 5.8 Returns to Buyers of Foreign Targets

Study	Cumulative Abnormal Returns (% or avg$/acq)	Sample Size	Sample Period	Event Window (Days)	Notes
Conn, Connell (1990)	−0.0787* a non-U.S.(DMM) −0.0677* a non-U.S.(IMM) −0.025 U.S. (DMM)	73	1971–1980	−1,0	"Non-U.S." and "U.S." indicate country of buyer firm. "IMM" indicates returns estimated using a market model

Mukherjee (2000)	relative GNP growth rates of two countries.				Focus is U.S. targets.
Kuipers, Miller, Patel (2003)	+23.07%† $121.86 MM†	181	1982–1991	–1,0	Focus is U.S. targets.

*Significant at the 95 percent confidence level.
†Significant at the 99 percent confidence level.

EXHIBIT 5.8 Returns to Buyers of Foreign Targets

Study	Cumulative Abnormal Returns (% or avg$/acq)	Sample Size	Sample Period	Event Window (Days)	Notes
Conn, Connell (1990)	–0.0787* a non-U.S.(DMM) –0.0677* a non-U.S.(IMM) –0.025 U.S. (DMM) –0.026 U.S. (IMM)	73	1971–1980	–1,0	"Non-U.S." and "U.S." indicate country of buyer firm. "IMM" indicates returns estimated using a market model with an international market index. "DMM" uses a domestic market index.
Kang (1993)	0.0059 Japanese buyers –0.029. U.S. buyers Difference is significant at 5%.	119 102	1975–1988	–1,0	Focus is non-U.S. buyers of U.S. targets.
Mathur et al. (1994)	–0.0026	77	1984–1988	–1,+1	Focus is non-U.S. buyers of U.S. targets.
Servaes, Zenner (1994)	0.0044 takeovers 0.0005 units and minority interests	70	1979–1988	–1,0	Focus is non-U.S. buyers of U.S. targets.
Eun, Kolodny, Scheraga (1996)	–0.0120 all observations 0.0318 Canadian buyers 0.0362 Japanese buyers –0.0428 U.K. buyers –0.0046 all other buyers	117	1979–1990	–5,0	Focus is non-U.S. buyers of U.S. targets.
Cakici et al. (1996)	0.0046* foreign bidder 0.0000 U.S. bidder	195	1983–1992	–1,0	Focus is non-U.S. buyers of U.S. targets.
Doukas, Travlos (1988)	0.009 All observations –0.0003 operating in target's country 0.011 not operating in target's country 0.0199* going abroad first time	301	1975–1983	–1,0	Focus is U.S. buyers of foreign targets.

(Continued)

EXHIBIT 5.8 *(Continued)*

Study	Cumulative Abnormal Returns (% or avg$/acq)	Sample Size	Sample Period	Event Window (Days)	Notes
Pettway, Sicherman, Speiss, (1993)	0.0152†	16	1981–1991	–1,0	Focus is Japanese buyers of U.S. targets.
Markides, Ittner (1994)	0.0032 all observations 0.0055 related acquisitions –0.0087 unrelated	274	1975–1988	–1,0	Focus is U.S. buyers of foreign targets.
Yook, McCabe (1996)	0.0046 all observations 0.0085 large acquisitions	98	1979–1989	–1,0	Focus is U.S. buyers of foreign targets.
Biswas et al. (1997)	0.00126 all observations 0.00277 U.S. buyer, foreign target 0.00015 foreign buyers, foreign targets –0.00399* U.S. buyer and target	125	1977–1987	–1,0	Focus is buyers of foreign targets.
Kiymaz, Mukherjee (2000)	Strong effects of monthly stock returns and relative GNP growth rates of two countries.	112	1982–1991	–1,0	Focus is U.S. buyers of foreign targets.
Eckbo, Thorburn (2000)	–0.0030 U.S. buyers 0.0171 Canadian buyers	390 1,261	1964–1983	–1,0	Focus is U.S. and Canadian buyers of Canadian firms.
Kuipers, Miller, Patel (2003)	–0.92% –$31.26MM	138	1982–1991	–1,0	Focus is foreign acquirers of U.S. targets.

*Significant at the 95 percent confidence level.
†Significant at the 99 percent confidence level.

EXHIBIT 5.9 Summary of Shareholder Return Studies for M&A: Combined Returns to Shareholders of Acquiring Firm and Target Firm

Study	Cumulative Abnormal Returns	Sample Size	Sample Period	Event Window (Days)	Notes
Eun, Kolodny, Scheraga (1996)	$68 million, average combined wealth changes. $398 million.	117	1979–1990	–5,0	Focus is non-U.S. buyers and U.S. targets.
Biswas et al. (1997)	$135.4 million, average combined wealth changes, international acquisitions; 3.39% as percentage of size. $2.04 million, domestic acquisitions; 2.02% as percentage of size. Both are significant at 5%.	125	1977–1987	–5,+5	Focus is buyers of foreign targets.
Kuipers, Miller, Patel (2003)	+2.99%* $121.86 MM†	120	1982–1991	–1,0	Focus is U.S. targets and foreign acquirers.

*Significant at 95 percent confidence level.
†Significant at 99 percent confidence level.

STRATEGIC ANALYSIS OF COUNTRIES: GETTING A VIEW

The extensive research on foreign direct investment and on investor reaction to announcements of cross-border acquisitions underscores how important it is for the practitioner to have a view about a country in which an acquisition is contemplated. Such a view would inform the analysis of deals with insights about:

- Expected economic growth in the country and region. Exhibit 5.10 depicts the development curve of a country over time, commonly used by economists to convey the evolutionary process by which a country achieves developed status. The country progresses from entrepôt (distribution center), through stages of rising value-added manufacturing, to highly integrated operations. In seeking to gauge the attractiveness of a country market, the M&A analyst can use a framework such as the path of development to assess the current status and future outlook for a country.
- Foundations of special competitive advantage stemming from unique resources or capabilities. Porter (1990) highlighted the role of clusters of competition within countries that creates capabilities.
- Outlook for inflation, interest rates, and exchange rates.
- Relative valuation of assets.

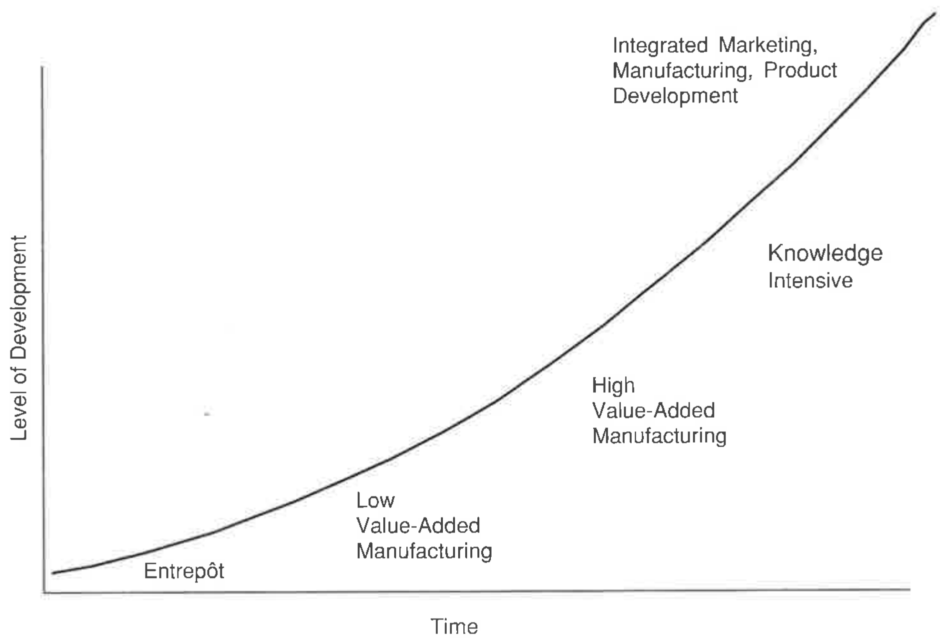

EXHIBIT 5.10 The Curve of Country Development

- Risks. Expectations about any of these elements are never certain. Country analysis should identify the sources of uncertainty and the size of their influence. A quick assessment of the risk in a country might be derived from its sovereign debt risk rating.

Most government issues are rated for default risk by major rating agencies. These form important assumptions that will underpin the cross-border deal evaluation outlined in Chapter 13. Four perspectives inform one's view: macroeconomic, microeconomic, institutional, and cultural.

Macroeconomic View

In the long run, national economic results are materially influenced by government policies in six areas:

1. *Fiscal policy.* This addresses the volume and priorities of government spending, as well as the means of financing that spending through taxes or the issuance of debt. Fiscal policy affects monetary, exchange rate, and employment policies. The key points of focus for an analyst are government surpluses or deficits, spending priorities, tax rates, and government indebtedness.
2. *Monetary policy.* Management of the national money supply through central bank and government activities is a major influence on inflation rates, interest rates, and currency exchange rates. Monetary policy affects fiscal policy, exchange rate policy, employment, and trade. Key points of focus for the analyst are interest rate levels and trends, inflation rates, the velocity of money, and government interventions that seek to influence these (e.g., open market transactions, bank reserve requirements, and discount window transactions).

3. *Exchange rate policy.* Governments may choose among a variety of alternatives from letting the national currency float against other currencies to fixing the rate of exchange (in terms of a commodity such as gold or other currencies). Exchange rates are closely linked to flows of capital and the national balance of payments. Exchange rate policy affects monetary, fiscal, trade, and employment policies. Key points of focus for the analyst are the trend and level of exchange rates, trade balances and capital flows (which indicate the relative supply and demand for the local currency), interventions in currency markets by the government or by supranational organizations such as the International Monetary Fund (IMF).
4. *Intervention policy.* Economies that are tightly centrally controlled by governments may be slow to adapt to innovations and changes in market conditions. On the other hand, intervention may dampen swings in economic activity. Governments intervene in business markets through industry regulations, state ownership of enterprises, the judicial system, and oversight of financial institutions. Key points of analysis are the severity of government regulations, the existence of centralized regulatory boards, policies on privatization or nationalization, the use of government subsidies to support private enterprise, the history of expropriation, and generally the development priorities indicated through government action in these areas.
5. *Trade policy.* Government policy can range from strong protectionism (through tariffs and other barriers) to free trade. Barriers may shelter the development of "national champions," but they restrict the inbound flow of goods and services to consumers in the country. In contrast, the theory of comparative advantage suggests that national welfare is maximized when goods trade freely across borders. Trade policy affects fiscal, monetary, and exchange rate policies. Key points of analysis are the size and distribution of tariffs across imported goods and services and the trend of flows of imports and exports.
6. *Employment and welfare policy.* Many countries seek to manage unemployment and stimulate the creation of jobs as the flip side of providing a social safety net of welfare and health care payments. Employment and welfare policy affect fiscal policy. The focus of analysis should be the trend and size of the unemployment rate, trend and size of social welfare payments in the economy, existence of labor unions, and laws and policies that affect union activity.

Microeconomic View

This second perspective on a country considers activity at the level of industries and firms. Of general interest to the analyst will be the demographic profile of the country's industrial base, the breadth of different industries, their maturity, and their prosperity. Central to microeconomic analysis is an understanding about average and marginal costs and revenues as indicators of the competitive advantage of individual firms, of entry barriers, and of the competitive makeup of industries. This view of a country is rooted in theory and research of industrial organization economics.

Porter (1990) argues that country performance is essentially a matter of microeconomic performance. Conventional thinking about national competitiveness, he says, is rooted in macroeconomics: trade balances, interest rates, exchange rates, labor costs, and economies of scale. Instead, he argues that national performance can be traced to processes of innovation and productivity improvement at the level of industries: "The only meaningful concept of competitiveness at the national level is *productivity*. . . . A nation's standard of living depends on the capacity of its companies to achieve high levels of productivity—and to increase productivity over time. Sustained productivity growth requires that an economy continually *upgrade itself*." (Page 76) Based on an analysis of competitive success in 10 trading nations, Porter concludes that the ability to innovate and to improve productivity resides in four interrelated factors. Exhibit 5.11 depicts these factors in the "diamond" of national competitive advantage:

- *Factor conditions.* These regard the inputs of production, such as labor, land, natural resources, physical facilities, and infrastructure. Human resources and intellectual capital are especially important in advanced national economies. Here the analyst should assess how specialized are a nation's factors, and how tailored they are to the needs of the acquisition target. Porter argues that "nations succeed in industries where they are particularly good at factor creation. Competitive advantage results from the presence of world-class institutions that first create specialized factors and then continually work to upgrade them." (Page 79)
- *Demand conditions.* The home-market demand for the goods or services of an industry will heavily influence the international success of that industry. Effective home demand can telegraph to domestic firms an earlier and clearer assessment of customer needs—the *guidance* from home demand is more important than its size. The best home demand arises from discerning and sophisticated customers. Here, the focus of the M&A analyst is less on aggregate demand than on segments and key customers (size, trends, and pressures within the customer group for cost, quality, and service). Thus, Porter says, "Sophisticated, demanding buyers provide a window into advanced customer needs; they pressure companies to meet high standards; they prod them to improve, to innovate, and to upgrade into more advanced segments." (Page 82)
- *Related or supporting industries.* No industry resides in a vacuum; instead, each depends on others for upstream or downstream assistance. The strength of these related industries will influence the success of an industry. Internation-

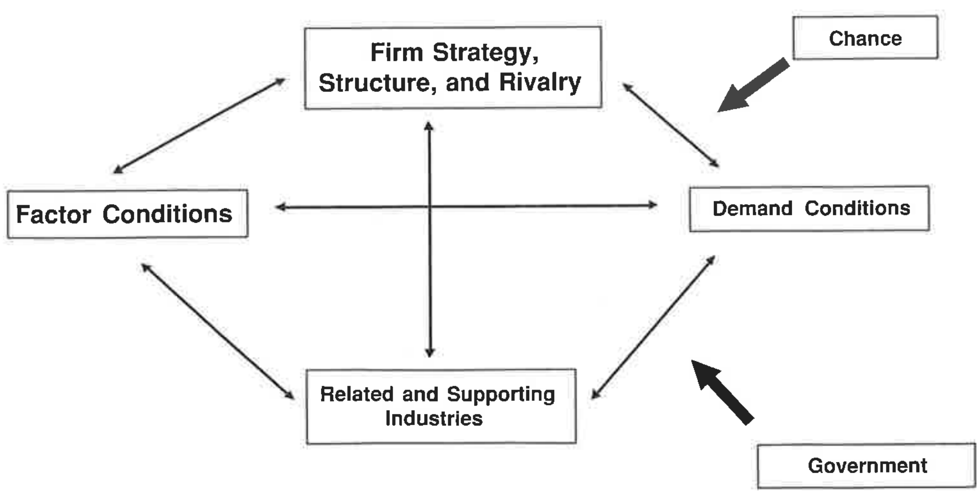

EXHIBIT 5.11 Porter's "Diamond" of National Competitive Advantage
Source: Porter (1990).

ally competitive suppliers "deliver the most cost-effective inputs in an efficient, early, rapid and sometimes preferential manner." (Pages 82–83) Close working relationships spur innovation and change through better information flow and technical exchange. Porter argues that this type of exchange within industrial "clusters" explains the dominance by countries of certain industries, such as leather footwear (Italy), chocolate confections (Switzerland, Belgium), machine tools (Italy), software (U.S.), and biotechnology (Denmark). The M&A analyst should consider the character of supplier industries: pressures for productivity improvement, internal competition, and key suppliers.

- ***Domestic rivalry and the strategy and structure of the competitors.*** Competition tends to strengthen the international competitiveness of local industries. The nature of that competition and the strategies adopted by individual rivals shapes the ability of that industry to withstand competition across borders. Cozy oligopolies created by high industry entry barriers will tend to stifle innovation and productivity improvement. Therefore, the analyst should assess the structure of competition in selected industries (e.g., by means of concentration ratios), evaluate the significance of entry barriers (especially barriers erected by governments), map the conduct of competition (e.g., familiar patterns such as leader-follower or territorial dominance by geographical area or industry subsegment), and look for the presence of "national champions." Porter writes, "Conventional wisdom argues that domestic competition is wasteful: it leads to duplication of effort and prevents companies from achieving economies of scale. The 'right solution' is to embrace one or two national champions, companies with the scale and strength to tackle foreign competitors, and to guarantee them the necessary resources, with the government's blessing. In fact, however, most national champions are uncompetitive." (Page 85)

These factors are self-reinforcing; they form a system. Dramatic improvement or deterioration in one factor will radiate through the others. This underscores the *cluster* nature of microeconomic strength in a country: the interlinkage of these factors amplifies industrial strengths (and weaknesses). Industrial clusters tend to arise in geographical proximity and from shared customers, technology, distribution channels, resources, and suppliers.

From the microeconomic vantage point, all national strength has local origins. Frameworks such as Porter's can help guide the analyst toward the identification of these sources.

Institutional View

The field of institutional economics emphasizes the important role played in national economic growth by a range of institutions that may not themselves be the direct producers of growth but that provide important economic infrastructure for development. In developed countries, these institutions are taken for granted. But in earlier stages of development (see Exhibit 5.10), the presence or absence of these institutions and the health of the institutions will affect the attractiveness of the country for foreign direct investment and acquisition. Institutions worth studying include these:

- *Banking.* In the 150 developing countries of the world, banks are practically the only means by which firms can acquire nonequity funds to grow. And within the developed world, the number and health of banks vary greatly. Measures of activity and soundness of banks (and thereby the banking system) include: loan growth, deposit growth, loan losses, capitalization (and especially in comparison with capital requirements imposed by country regulators and supranational organizations such as the IMF), return on equity, return on assets, and operating ratio (operating income divided by operating expenses).
- *Stock market and investment regulations.* The local stock market is a bellwether of integration from local markets to the global market. Indicators of stock market conditions are the number of listings, the daily trading volume, the number of initial public offerings, the height and trend of stock prices (especially the local stock market index), presence of sophisticated institutional investors, breadth of share ownership among households within the country, and concentration of share ownership of firms. Of vital importance to integration is the presence or absence of controls on the cross-border movement of capital, restrictions on share ownership by foreigners, and generally the adoption of market regulations in harmony with world market standards.
- *Watchdogs: auditors, free press, opposition political parties.* Transparency of financial reporting and the adoption of accounting principles by active professional auditors in the local country are foundations of strong banking and stock market systems. But the country analyst should broaden the assessment to include other institutions that also play a watchdog role such as journalists and opposition politicians. Issues of particular importance are the suppression of governmental and corporate corruption. Some international business organizations publish corruption indexes.
- *Independent judiciary, rule of law, respect for contracts and property rights.* Expropriation of wealth by government or by a private mafia is the nightmare of foreign direct investors. One measure of relief from these risks is the soundness of the system of justice in the local country. Failures of the judicial system often parallel failures in watchdog groups; therefore, information in the public domain may not give a clear indication of the strength of local justice. Here, interviews with local foreign investors will be indispensable. Respect for civil rights is another indicator of the integrity of the system of justice. Give careful attention to freedom of speech, freedom of religious observance, and respect for the rights of minorities and women.
- *Educational system.* Literacy rates, schooling requirements, and the number and health of educational institutions give demographic backing to conclusions about the likely strength of the workforce, of human capital, and of the possible generation of new intellectual property.

Cultural View

Economic growth may also be culturally determined by factors such as work ethic, leadership, and entrepreneurship. Great ingredients do not guarantee a tasty dinner—such an outcome depends importantly on the cook. The M&A country analyst needs to assess the ability of the local culture to nurture these important attributes. Any scientific effort to do so borders on organizational psychology and

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guarantee a tasty din-
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rture these important
tional psychology and

anthropology, disciplines well beyond the scope of this book. But one can start a rich process of observation by focusing on inflection points in the foreign culture: selection of leaders, treatment of upstarts, tolerance of risk and of failure, and appetite for profit.

Exhibit 5.12 summarizes these factors and graphically suggests that the four categories (macroeconomic, microeconomic, institutional, and cultural) jointly complete the mosaic of assessment. A view about the economic future of a country relies on a coherent assessment of all perspectives.

SUMMARY AND IMPLICATIONS FOR THE PRACTITIONER

This chapter has argued that the M&A practitioner should widen his or her frame of reference to embrace the global market. The volume of cross-border M&A is large, and, if present trends of market integration continue, will get larger. Research suggests that *foreign buyers pay more*, creating a natural incentive for target shareholders to entertain offers from across borders. Certainly, the drivers of M&A outlined in this chapter echo the drivers of domestic M&A: Chapter 4 portrayed market turbulence as the primary driver. If anything, the cross-border arena displays more turbulence.

Cross-border M&A activity and its drivers pose some important implications for the practitioner.

- *Get a view about countries and regions.* In the turbulent world arena, perhaps the worst stance is to be myopic, naive, and uninformed. This chapter gave a

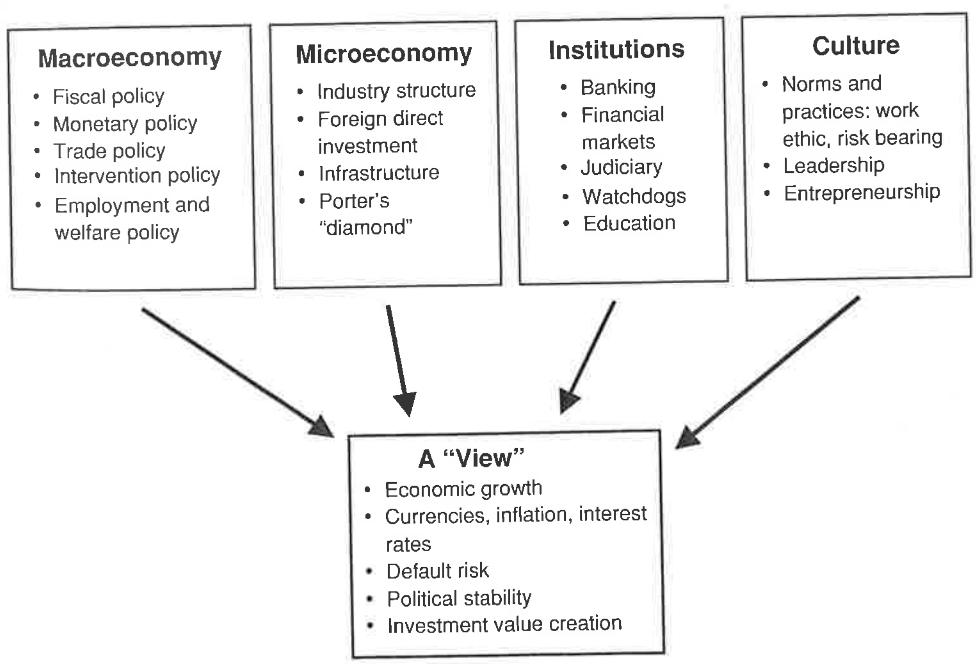

EXHIBIT 5.12 Country Analysis Based on Four Perspectives

rough sketch of four perspectives that can aggregate to a view: macroeconomic, microeconomic, institutional, and cultural. These perspectives are not easily given to a checklist of data to acquire or analysis to do. Country analysis is a process of diagnosis (like medicine) rather than design (like engineering). Skills of investigation and reflection are important foundations for cross-border M&A.

- *Consider local and global turbulence and how it changes competition across borders.* Attend to the sources of turbulence and its impacts—insights about these will spring from analysis of countries and regions. But one can also look to the well-known sources (technological innovation, deregulation, trade liberalization, demographic change, and market integration) and study their impacts on countries. Of special interest are "inflection points" or changes in economic or competitive conditions that may generate special investment opportunities. Also consider that turbulence usually has an asymmetric impact across countries—M&A can afford one form of arbitrage across these asymmetries.
- *Anticipate the reaction of competitors.* Global market integration will admit new competitors to country arenas. But to the extent that trade blocs may restrict the entry of outsiders into your market, it becomes extremely important to anticipate the competitive actions and reactions of competitors. It is reasonable to assume that competitors within, and outside of, the bloc recognize both the effects of turbulence and the associated asymmetries.
- *Anticipate the reaction of investors.* A mental trap of cross-border M&A is business imperialism, the view that your firm must "own" a place in a foreign market simply for its own sake. Under this view, the decision maker is distracted from a fundamental aim of capitalist enterprise, to create value for investors. The rise of sophisticated global financial intermediaries such as banks, mutual funds, and pension funds creates vocal investors who focus on value creation. The implication is that the logic of value creation will assume greater, not less, importance in accessing capital with which to finance M&A activities.

NOTES

1. In theory, the value of outbound M&A from the United States should not exceed outbound foreign direct investment. A close comparison of the exhibit will show that in some years this is not true. Most likely this anomaly is due to differences in the timing and value of flows of the two different series of information. But the qualitative point remains that M&A accounts for the bulk of foreign direct investment into and out of the United States.
2. A discussion of the UNCTAD finding is given in Dunning (1998). This is consistent with the findings of Pereiro (1998), who found that acquisitions account for 52 percent of all private foreign direct investment in Argentina from 1991 to 1997.
3. This is the thesis of Bleeke and Ernst (1996), who argue that many strategic alliances are de facto sales. Their clinical research on joint ventures and alliances revealed that many were founded on a belief that the business unit could not survive alone and, in effect, required at least partial ownership by an ally. They noted that frequently these partnerings end in a complete sale of the unit by the former parent.

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that many strategic al- : ventures and alliances business unit could not ıership by an ally. They e sale of the unit by the

4. Conn and Nielsen (1990) found that horizontal and vertical acquisitions represent 60 percent of deals for U.S. acquirers and 70 percent of deals for U.K. acquirers. Eun et al. (1996) found that 75 percent of foreign firms acquiring into the United States were buying into related businesses.
5. Conn and Nielsen (1990) found that 97 percent of U.S. acquirers and 93 percent of U.K. acquirers paid with cash. Ceneboyan et al. (1992) found that foreign buyers into the United States favored cash deals (85 percent), compared to 46 percent for domestic U.S. buyers.
6. Euroland includes 11 countries (Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Portugal, and Spain), which adopted the euro as a common currency on January 1, 1999. Within the European Community, other agreements commit members to open borders and to the alignment of tax and regulatory policies. The North American Free Trade Agreement (NAFTA) embraces Canada, Mexico, and the United States with reductions in trade barriers and tariffs.
7. Hostile bids contemporaneous with the formation of the EMU included:
   - Olivetti's hostile bid for the leading Italian telecommunications firm, Telecom Italia, the sixth-largest telephone company in the world. Olivetti's financial advisers were Italy's Mediobanca and three American firms: Donaldson, Lufkin & Jenrette; Lehman Brothers; and Chase Bank. Instituto Mobiliare Italiana and three American firms advised Telecom Italia: J. P. Morgan, CS First Boston, and Lazard. Olivetti's bid was denominated in euros and would be financed by the issuance of a "megabond" on the euro capital markets worth $15 billion.
   - Luxury-goods manufacturer LVMH Moet Hennessey Louis Vuitton's "creeping takeover" of Gucci. This contest featured a variety of legal maneuvers and antitakeover defenses.
   - Banque Nationale de Paris' hostile bid for *both* Societe Generale and Paribas, which would create the largest financial institution in the world, with assets of more than $1 trillion. In the outcome, BNP successfully acquired Paribas and a one-third interest in Societe Generale.

   North America witnessed hostile transactions across NAFTA members that might not have been possible before the formation of the trading bloc:

   - In 1999, Grupo Mexico successfully mounted an unsolicited offer for the U.S. copper producer Asarco, snatching the target from the U.S. bidder, Phelps Dodge.
   - American Airlines and Onex, a U.S. private equity investment firm, made an unsolicited offer for Air Canada.
8. See Vernon (1974), Kindleberger (1969), Caves (1971), Buckley and Casson (1976), Magee (1976), and Dunning (1988).
9. See Caves (1971) and Magee (1976).
10. For discussions about global tax arbitrage by corporations, see Lessard (1985), Lessard and Shapiro (1983), and Rutenberg (1985).
11. Harris and Ravenscraft (1991) found that changes in U.S. tax laws are not related to cross-border acquisition returns. Dewenter (1995) found no relationship between U.S. tax regime changes and cross-border M&A activity.

However, Servaes and Zenner (1994) did find significant variation in returns to investors based on changes in tax laws. Manzon, Sharp, and Travlos (1994) found that cross-border acquisition announcement returns are not related to tax differences between the buyer and target country.

12. The recent literature on emerging markets integration lends rich insight into the sources of variability in returns, volatilities, and correlations. See, for instance, Bekaert and Harvey (1995, 1997), Bekaert, Erb, Harvey, and Viskanta (1997), Bekaert, Harvey and Lumsdaine (2002), Wurgler (2000), and Errunza and Miller (2000).
13. Agmon and Lessard (1977) find evidence that MNC betas reflect international involvement well. In contrast, Jacquillat and Solnik (1978) and Senchak and Beedles (1980) conclude that the effect of international diversification on a firm's beta is less than direct, or at least nonlinear.
14. To diversify across global industries is to base portfolio allocations on industry choice *first* and then to pick the most attractive stocks within the industry, irrespective of country.
15. See, for instance, Lessard (1976), Solnik (1976), Solnik and de Freitas (1988), and Grinold, Rudd, and Stefek (1989).
16. Regarding findings about the rising influence of industry in explaining the cross section of global investing returns, see Diermeier and Solnik (2001), Cavaglia, Brightman, and Aked (2000), and Lombard, Roulet, and Solnik (1999). Studies that support the continued dominance of country choice include Heston and Rowenhorst (1994), Rowenhorst (1999), Kritzman and Page (2002), Gerard, Hillion, and de Roon (2002), and Isakov and Sonney (2002).
17. Tobin's Q is measured as the ratio of market value divided by book value.

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INTRODUCTION

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  create value. Key
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