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CROSS-BORDER MERGERS AND ACQUISITIONS BETWEEN INDTRIALIZED AND DEVELOPING COUNTRIES

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Abstract

In this paper we study the cross border mergers and acquisition between US. and Indian firms. Our empirical work suggests that US firms realize significant losses on the announcement of acquisitions of Indian targets while Indian targets realize significant gains on the announcement of mergers with acquirers. Publicly traded Indian firms realize insignificant returns on their announcement of acquisitions of publicly traded US firms but realize significant positive returns on announcements of acquisitions of privately held firms and subsidiary firm targets. Publicly traded targets realize insignificant gains when acquired by Indian firms.

Keywords: Cross border mergers and acquisitions, Acquirer's abnormal returns, Target's abnormal returns, Publicly traded acquirers, Privately held targets

JEL Classification: G34, G14

1. Introduction

Much of the current research on cross border mergers focuses on analyzing the returns of industrialized firm's acquisitions of emerging world targets.¹ Little attention has been give to acquisitions of developed country targets by emerging world country firms. Also, researchers have focused primarily on the returns to the acquirers and none of the studies to date have investigated the effect of announcement of mergers and acquisitions on the

¹ We e "emerging" and "developing" interchangeably and "indtrialized" and "developed" interchangeably throughout the paper.

target firms in the cross border mergers and acquisitions involving developed and developing world firms. We study both types of cross-border merger activity by examining Indian and company returns when firms are acquirers of Indian firms and when Indian firms are acquirers of firms.² We find that there is no country effect when a publicly traded firm acquires a publicly traded target or subsidiary firm target but there is a significant country effect for public traded acquirers of privately held targets (acquirers earn significantly lower returns than Indian acquirers). Our investigation for the target firms reveals that acquisition by any firm (public, private or subsidiary firm) is beneficial to the shareholders of the Indian targets whereas the public targets earn insignificant returns on the announcement of their acquisition by Indian firm. We also find that the abnormal returns for the targets of publicly traded acquirers are consistently higher than the abnormal returns of targets of privately held acquirers.

Figure 1 shows the dramatic increase over the last few years in mergers and acquisitions between US and Indian companies. Prior to 1995 there were few cross border mergers and acquisitions between and Indian firms. Post 1995, US acquisitions of Indian targets reached more than 100 firms in 2000, then declined rapidly following the dot.com bubble burst. By 2006, US acquisitions of Indian targets were again close to 100 firms. Indian acquisitions of US firms followed a similar pattern with increases up to the year 2000 (but only about 50 transactions) then a decline following the dot.com bubble burst. By 2006, the number of transactions had risen above the year 2000 level. In Figure 2, we separate the cross-border mergers and acquisitions by type of ownership structure – publicly traded, privately held or non-traded subsidiary. The figure shows that Indian acquirers of US firms are largely publicly traded firms whereas the US targets are typically privately held firms. Mergers and acquisitions between US acquirers and Indian

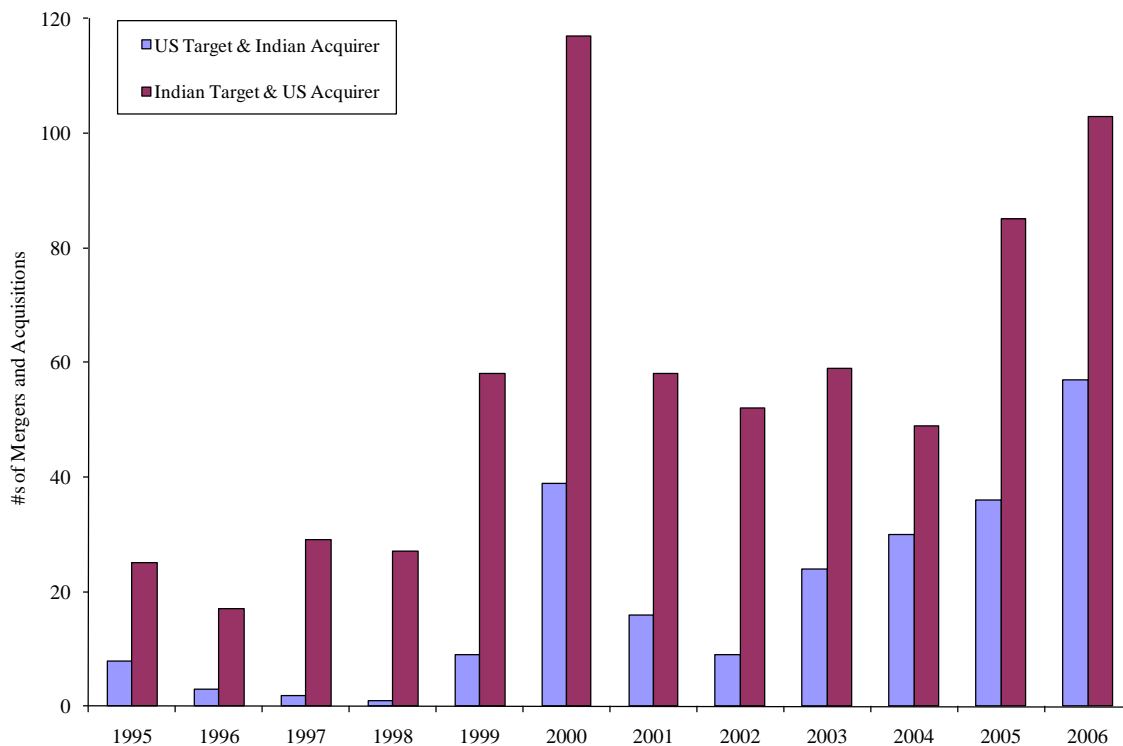
² The economic environment and the business environment of countries play a crucial role in the decision to acquire or being acquired in cross border merger and acquisitions (La Porta, Lopez, Shleifer and Vishny 1998, 1999, 2000), we cannot get meaningful information by studying all developed world and developing world countries together. Doing the merger and acquisition study for all the developing world countries separately in one paper would make the paper too voluminous. Hence we limit the scope of this paper to mergers and acquisition in India and between India and the US and leave the mergers and acquisition in the remaining developing countries as a topic for future research.

targets are spread across the publicly traded, privately held and subsidiary firms for both acquirers and targets.

Conn, Cosh, Guest and Hughes (2005) assert that there are important theoretical reasons why the acquisition of domestic and cross border targets may differ and why acquisition of private targets may differ from the acquisition of public targets.³

Figure 1: Number of mergers and acquisitions, 1995 to 2006

Figure 1 shows an increasing trend in the number of mergers and acquisitions within Indian and between U.S. and Indian firms.



Source: SDC Mergers and Acquisitions Database

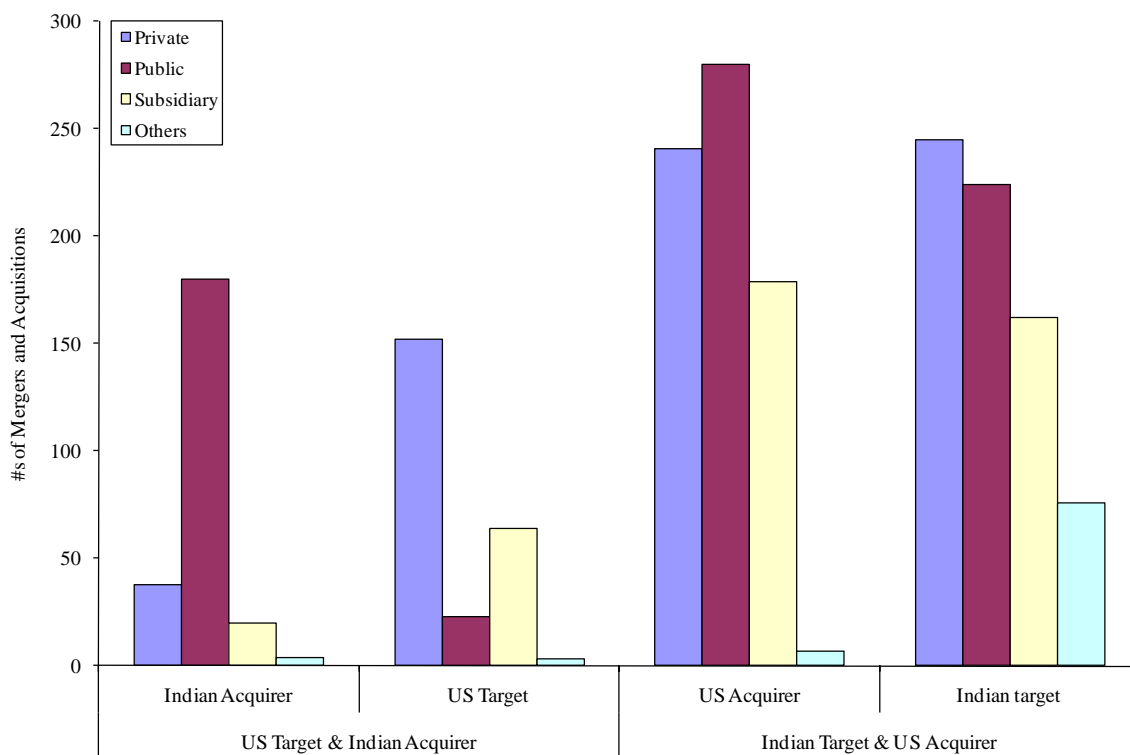
Accordingly, we examine mergers and acquisitions between US and Indian firms by separating them into different pairings: publicly traded acquirers and publicly traded

³ We refrain from the discussion as to why cross border mergers and acquisitions are different from domestic mergers and acquisitions and why acquisition of private targets is different from the acquisition of public firms. Those issues are discussed at length in section 2 of Conn *et al.* (2005).

targets, publicly traded acquirers and privately held targets, publicly traded acquirers and subsidiary firms, privately held acquirers and publicly traded targets and subsidiary firm acquirers and publicly traded target firms.

Figure 2: Types of mergers and acquisitions

In the following figure we categorize the mergers and acquisitions by publicly traded firms, by privately held firms, by subsidiaries of large firms and by others (government firms, joint ventures etc.). Indian acquirers of U.S. firms are largely public and private firms but the U.S. targets are largely privately held and subsidiaries of large firms. Mergers between U.S. acquirers and Indian targets are spread across publicly traded, privately held and subsidiary firms for both acquirers and targets.



Source: SDC Mergers and Acquisitions Database

There is a substantial literature on the announcement effects of cross-border acquisitions on acquiring firms in developed countries such as the US and UK but there is limited work that has been done examining mergers and acquisition between the acquirers and targets of a developing country (such as India) and an industrialized country (such as the US). In cross border mergers and acquisitions studies involving acquirers, Moeller and Schlingemann (2005) have 1 target Indian firm, Francis, Hasan and Sun (2008) have 13 target Indian firms, and Chari, Ouimet and Tesar (2010) have 33 target Indian firms in their sample. Using a comprehensive sample of 248 firms, in this paper we study the announcement effect of mergers and acquisitions on the acquirers of Indian targets. Also, none of the studies done to date have studied the announcement effect of mergers and acquisitions on the target shareholders of the firms from developing world. Conn *et al.* (2005) state that despite the increase in the acquisition of cross-border public and non-public targets, nearly all acquisition studies are limited to domestic targets which are publicly traded. They study the acquisitions of both domestic and cross-border targets that are public and private but they limit their study to the affect of acquisition on UK acquirers only. Utilizing merger and acquisitions data from 1995 to 2007 we address the announcement effect on publicly traded acquirers of publicly traded, privately held and subsidiary targets, and on publicly traded targets by privately held firms for US acquirers and Indian targets and Indian acquirers US targets.

We find that Indian target firms when acquired by a publicly traded U.S. firm, realize positive abnormal returns around the announcement date whereas acquiring firms suffer a loss of market value around the announcement date. Indian targets acquired by privately held US firms enjoy significant gains on the announcement of a merger or acquisition. In the case of an Indian acquisition of a US target, the acquiring Indian firm experiences positive abnormal returns around the announcement date. The returns to an Indian acquirer of a publicly traded US firm are statistically insignificant whereas Indian acquirers realize significant abnormal returns around the announcement date of the acquisition of privately held US firms and the subsidiaries of US firms. US targets realize statistically insignificant returns on the announcement of a merger or acquisition by Indian firms.

Our results indicate that the shareholders of Indian acquirers of privately held US targets and US subsidiary firm targets gain from the announcement of an acquisition whereas the share prices of US acquirers of privately held Indian targets fall on the announcement of an acquisition.⁴ We investigate if this difference in cross border mergers and acquisitions is due to firm characteristics or is due to the country environment. We examine the firm characteristics of the acquirers and find that Indian and the US acquirers of privately held targets have similar high tech status and similar diversification levels. Indian acquirers of US subsidiary targets have substantially greater high tech stat and higher diversification levels than the US acquirers of Indian subsidiary targets. For all target categories, the relative size of targets is substantially smaller for US acquisitions. The market value of Indian acquirers is also significantly lower than the market value of US acquirers. Both Indian and firms, acquire majority stakes in target firms but the average stake acquired is higher in private and subsidiary firm targets than in publicly traded targets.

To determine if the reaction to the news of an acquisition is due to firm specific characteristics, we regress the three day cumulative abnormal return around announcement (-1 day to +1 day after announcement) on firm specific characteristics and a dummy variable identifying the country of the acquirer. Our results indicate that there is no influence of the country environment when a publicly traded firm acquires a publicly traded target or subsidiary firm target as the dummy variable for the country remains insignificant. The dummy variable is significant for public traded acquirers of privately held targets indicating that the acquirers earn significantly lower returns than Indian acquirers.

Our results differ from the recent research of Chari, Ouimet and Tesar (2010) and Gubbi, Aulakh, Ray, Sarkar and Chittor (2010). Chari *et al.* (2010) study the returns to the developed market acquirers of emerging market firms. They report a positive and

⁴ Our results are consistent with the findings of Moeller and Schlingemann (2005) and Denis, Denis and Yost (2002), who find that cross-border M&As for acquirers decrease acquirers' value. Our results do not support the findings of Chari *et al.* (2010), Francis, Hasan and Sun (2008), Kiyamaz (2004), Doukas (1995), and Doukas and Travlos (1988), who find that cross-border M&As are value enhancing for acquirers.

significant abnormal return for the developed country acquirer of targets from emerging markets whereas we find a negative but insignificant abnormal return for the acquirers of Indian targets. They find that private targets are associated with significantly higher announcement returns for acquirers from developed world countries whereas we find acquirers of private Indian targets earn significantly negative abnormal returns.

Gubbi *et al.* (2010) do find that the Indian acquirers of foreign targets (both developing and developed country firms) gain on the announcement of their mergers and acquisitions. However, when they regressed the abnormal returns on explanatory variables, the coefficient on private targets is positive and insignificant in one model (as in their Table 4) and negative and insignificant in the other (in Table 5). We find that Indian acquirers of targets earn significant, positive abnormal returns on the announcement of their acquisitions of targets but this gain is limited to the acquisition of private targets only.

The size of our sample allows us to avoid the grouping of targets and acquirers from different countries. Whereas, the developed world countries are somewhat economically and culturally similar to each other there are large differences across the countries of emerging markets. Studying cross border mergers and acquisitions between representative developing and industrialized countries should provide less noisy information.

The rest of the paper is organized as follows: Section 2 reviews related literature and Section 3 discusses the data sources and methodology. Section 4 presents the empirical results. Section 5 provides some of the probable cases for the gains/loss of the shareholders of acquirers and targets, and section 6 concludes.

2. Literature Review

We summarize the literature on cross border mergers and acquisitions in Table 1; US targets gain significantly when acquired by foreign firms, foreign acquirers of U.S. firms gain significantly whereas the U.S. acquirers of foreign firms show mixed results. The firms in these studies are predominantly from industrialized countries.

Table 1: Summary of literature on cross-border mergers and acquisitions

Cross Border	Data	Time Period	Event Window	Target Shareholders	Acquirer Shareholders
Markides and Ittner (1994)	276 US international acquisitions	1975 to 1988	1 day prior to the announcement date	Not Studied	0.32% gain (significant)
			10 days prior to 10 days after announcement date	Not Studied	0.29% gain (not significant)
Seth et al. (2002)	100, between foreign acquirers and US targets	1981 to 1990	10 days prior to 10 days after announcement date	38.3% gain (1%)	0.11% gain (insignificant)
Eun, Kolodny and Scheraga (1996)	225 foreign acquisition of US firms	1979 to 1990	5 days before to 5 days after announcement date	37.02% gain(1%)	
Cakici, Hessel and Tandon (1996)	195 foreign firms that acquired US firms and 112 US acquisitions of foreign firms	1983 to 1992	1 day prior to announcement date	Not Studied	0.63% gain (1%) for foreign acquirers and 0.36% loss (insignificant) for US acquirers
			10 day prior to 10 days after announcement date	Not Studied	1.96% gain (1%) for foreign acquirers and 0.25% loss (insignificant) for US acquirers
Markides and Oyon (1998)	236 acquisitions by US companies in Europe and Canada	1975 to 1998	1 day prior to announcement date		0.38% gain (5%)
Eckbo and Thorburn (2000)	390 acquisitions of Canadian targets by US firms	1962 to 1983	during the month of merger announcement	3.59% gain (1%)	0.19% loss (insignificant)
Conn et al (2005)	4000 UK domestic and cross border public and private targets	1984 to 1998	1 day prior to 1 day after announcement date	Not Studied	For Public Targets: 0.82% loss(1%) for all targets, 0.99% loss (1%) for domestic, 0.09% loss(insignificant) for cross border
				Not Studied	For Private Targets: .86% gain (1%) for all targets, 1.05% gain (1%) for domestic and 0.38% gain (5%) for cross border targets
Moeller and Schlingemann (2005)	4430 domestic and cross-border acquisitions by US acquirers	1985 to 1995	1 day prior to 1 day after announcement date	Not Studied	For US acquirers of the cross-border sample: 0.307% (insignificant); for US acquirers of the domestic sample 1.173% (1%)
Francis, Hasan and Sun (2008)	1491 US acquisitions of foreign firms and 7612 US domestic acquisitions	1990 to 2003	1 day prior to 1 day after announcement date	Not Studied	For US acquirers of the cross-border sample: 0.96% (1%); for US acquirers of the domestic sample: 1.49% (1%)
Chari, Ouimet and Tesar (2010)	594 developed-market acquisitions of firms in emerging markets and 1624 acquisitions of firms in developed markets.	1986 to 2006	1 day prior to 1 day after announcement date	Not Studied	For developed-market acquirers of firms in developing markets: 1.16% (significant); insignificant return for developed-market acquirers of firms in developed markets
Gubbi, Aulakh, Ray, Sarkar and Chittor (2010)	425 cross-border mergers and acquisitions by Indian firms	2000 to 2007	5 days prior to 5 days after announcement date	Not Studied	2.58% gain (5%)

Markides and Ittner (1994) examine 276 U.S. international acquisitions made from 1975 to 1988 and find the two-day cumulative abnormal return (CAR (-1, 0)) for acquiring firms to be 0.32% (statistically significant). Most of the acquisitions in Markides and Ittner's study come from manufacturing and finance and insurance industries and are from predominantly developed countries.

Markides and Oyon (1998) use a sample of 236 US acquisitions consisting of 47 Canadian targets and 189 European targets (32 from France, 81 from UK, 27 from Germany, 13 from Italy, 14 from Spain, 15 from Holland and 7 from Belgium) and find that US acquisitions in Europe generate significant returns while returns for US acquisitions in UK and Canada are not significant.

Seth, Song and Pettit (2002) investigate 100 cross border acquisitions between foreign acquirers and US targets during the time period 1981-1990. They find that the cumulative abnormal return (CAR (-10, 10): 10 days before and 10 days after the first bid by the ultimately successful bidders) to the foreign bidder is 0.11 per cent.⁵ The acquirers of the 100 cross border acquisitions in this study are mainly from industrialized countries - Great Britain (52), Japan (10), Canada (10), Australia (8), West Germany (3), and Switzerland (2).

Conn *et al.* (2005) study 4,000 UK domestic and cross border public and private acquisitions. For the acquirers of publicly traded targets they find significant losses for domestic mergers and acquisitions but insignificant losses for cross border mergers and acquisitions. They find significant gains to acquirers of privately held firms for both domestic and cross border targets.

Moeller and Schlingemann (2005) study the announcement effect on US acquirers for a sample of 383 cross border transactions and 4047 domestic takeover transactions during 1985 to 1995. They find a three-day (-1, +1) market adjusted return of 0.307 per cent for cross border acquirers and 1.173 per cent for domestic acquirers. In the Moeller

⁵ Seth *et al.* (2002) did not study the returns for the targets. Also, the statistical significance of the CAR is not reported in their paper.

and Schlingemann (2005) study, the UK is the most frequent target country (31%), followed by Canada (21%), France (9%) and Germany (9%). In their sample there is only one target firm from India.

In a recent study Francis, Hasan and Sun (2008) use a sample of 1491 foreign acquisitions by US firms and 7692 US domestic acquisitions. They find that over the full sample period of 1990-2003, acquirers in domestic M&As experience an average abnormal stock return of 1.49 per cent whereas the acquirers in cross-border M&As experience an average abnormal return of 0.96%. Among their 1491 transactions, 1275 (85.50%) are from integrated financial markets, with the remaining 215 (14.50%) from segmented financial markets. There are only 13 Indian firms acquired by US firms in this sample.

Most merger and acquisition studies have focused on publicly traded firms within the domestic US market or those between the U. and other industrialized countries. Little research has examined the returns to shareholders from cross-border mergers and acquisitions between U.S. and developing country firms.⁶ Chari, Ouimet and Tesar (2010) fill this gap and examine the returns to shareholders of developed country firms that undertook acquisitions in emerging markets. They find that when developed country acquirers gain control of emerging-market targets, they experience positive and significant abnormal returns of 1.16 per cent, on average, over a three-day event window. Though *Chari et al.* (2010) have studied the acquisition of targets from India by developed world firms there are only 33 target firms from India. In this paper we have a sample of 248 firms from the acquiring targets in India. Chari et al (2010) do not study the effect of announcement of mergers and acquisition on target firms. Also, they do not study acquirers of targets from developed world firms (like US) by developing world firms (like India).

⁶ Francis, Hasan and Sun (2008) have only 14 per cent of their cross border sample from developing countries and the Moeller and Schlingemann (2005) study has only 5.2 per cent of targets from developing countries. Rossi and Volpin (2004) examine the determinants of cross-board mergers and acquisitions from 1990 to 1999 with few of their targets firms from developing countries.

Research by Gubbi, Aulakh, Ray, Sarkar and Chittor (2010) study 425 foreign mergers and acquisitions by Indian firms from January 2000 to December 2007. They find positive abnormal returns for the acquiring firm shareholders when combining all target firm countries (developing and emerging) into one group. They investigate if the abnormal returns for the acquirers of developed world targets are different than those for emerging world target and find that acquirers have statistically higher abnormal returns when the target firms are located in advanced economies. They also investigate if the returns for the acquirers of private targets are different than the returns for public targets but find no significant results. In their Table 4 they perform a cross sectional regression on the abnormal return for the acquirers around announcement date and report a negative and insignificant 'private' variable which is one for private targets and zero for public targets. In their Table 5, Gubbi *et al.* (2010) report a positive an insignificant 'private' variable for a different cross sectional regression model. Hence their findings on the abnormal returns to the acquirers for different public/private stat are ambiguous. Also, Gubbi et al (2010) do not study the announcement effect of mergers and acquisitions on the target firms.

Cross border mergers and acquisitions can be beneficial for the acquirers resulting in positive abnormal returns on the announcement date; they can also result in losses for the acquirers. Researchers have given several reasons for the gains from cross border mergers and acquisitions. Caves (1971, 1998), Morck and Yeung (1991, 1992) and Williamson (1979) point to the internalization benefits in the cross border mergers & acquisitions. Firms extract above normal returns from cross border investments by internalizing host country market imperfections when their firm specific assets cannot find comparable values elsewhere. Ayban and Ficici (2009) note that the resulting rents derived from internalization are expected to be capitalized into a higher value of the firm. Baldwin and Caves (1991) point out that cross border mergers and acquisitions may result in gains from diversifications when business seek synergies arising from intangible and information based assets like brand names, technical knowledge and R&D expertise. According to Kogut (1983) cross border acquisitions may increase the operational flexibility of firm by giving it the opportunity to exploit market conditions. Conn et al

(2005) state that in cross border merger, geographical diversification by direct investments in overseas subsidiary permits firms to expand the boundary of the firm. This will result in increase in revenues for the firm.

Researchers give several reasons for the loss from cross border mergers and acquisitions. Conn *et al.* (2005) argue that overseas targets are more difficult to value accurately because of imperfect information. They point out that there are difficulties of managing the post merger process when cultural differences makes integration and acculturation, a difficult, time consuming and expensive process. The bigger the cultural gap the bigger the relative size of the target the worse the problem may be. Aybar and Ficici (2009) point out that, differences in natural culture, customer preferences, business practices and institutional forces may jeopardize the potential gains of cross border mergers and acquisitions. Hitt, Hoskissons and Ireland (2001), Hitt, Ireland, Camp and Sexton (2001) and Kissin and Herrera (1990) point out that complication in target assessments, misidentification of asset complementarities, informational asymmetries and high premiums paid for target may have adverse effects on the value of acquiring firms.

The above factors influence the developed and developing country firms differently. Furthermore, when a firm from developed country acquires developing country firm, it gains from the cheap labor thus reducing its operational cost whereas when a firm from developing country acquires developed world firm, it accesses the technological knowhow thus increasing the growth potential for the firm. In their studies, Chari *et al.* (2010) have grouped countries into developed markets and emerging markets and Gubbi *et al.* (2010) have clubbed developed and developing world target countries together. Whereas, the developed world countries are economically and culturally similar to each other and can be grouped together, there exist noticeable differences across the countries of emerging markets. While the countries in the developed world are all democracies, there are different government structures in the emerging world countries. Whereas the countries in the developed world predominantly follow same religion and have similar culture, there are differences in the cultural and religious practices of emerging world population. Whereas the judicial system in the developed world countries is strong, it's not so strong in all the emerging world countries.

The financial markets in all the developed world countries can be considered to be at least weak form efficient; the financial markets for many emerging world countries are not even weak form efficient. Due to the difference within the emerging world countries, a fundamental factor may play an important role in one emerging world country but may not be important for mergers in other emerging world countries. It may also be that because of the differences across emerging world countries effects due to fundamental factors may cancel out when we club the data from different countries together. Studying the cross border mergers and acquisitions between two countries at a time especially when the merger and acquisition is between developed world and emerging world countries would hence provide more meaningful information. Also combining all targets in one group may cancel the effects of their different organizational form hence one should be caution in deriving any inference from the papers studying all targets together and more meaningful information can be derived by splitting the targets into public and private.

In this paper, we examine the gains and losses to shareholders of both targets and acquirers, from mergers and acquisitions between the US and the developing country of India by separating the targets into their organizational form (public, private and subsidiary firms). The overall purpose of our analysis is to bring new evidence to view on shareholder wealth from cross-border (especially when the acquirer is from emerging world country) merger and acquisition activity.

3. Data, variables and methodology

This study focuses on cross-border acquisitions between the US and India announced over the period January 1995 – August 2007.⁷ We extract our merger and acquisition sample from SDC's (Securities Data Corporation, a database from Thomson Financial) Mergers and Acquisitions database during the sample period of January 1995 to August 2007. We use CRSP for daily returns and daily index returns for US firms and DataStream for the stock prices of Indian firms. We use the BSE200 (Bombay Stock

⁷ We start the data in 1995 as there are very few mergers and acquisitions between Indian and U.S. firms before that time.

Exchange) and the BSE500 from DataStream for the Indian market index. The BSE 500 is a more compensative index than BSE200, but it was first introduced on February 1, 1999. Hence, we use BSE200 as Indian market index during 1995-1998 and BSE500 as Indian market index after 1998.

Table 2: Number of acquiring and target firms in the Sample

This table shows the number of acquiring and target firms in our initial sample and the final sample for the mergers and acquisitions between the firms of US and India and the mergers and acquisitions within India.

Type of Merger and Acquisition	US Target & Indian Acquirer			Indian Target & US Acquirer		
	Total M&A	Data available for US Public Firms	Data available for Indian Public Firms	Total M&A	Data available for US Public Firms	Data available for Indian Public Firms
Private Acquirer & Private Target	24			90		
Private Acquirer & Public Target	4	4		71		34
Private Acquirer & Subsidiary	9			53		
Public Acquirer & Private Target	110		81	88	83	
Public acquirer & Public Target	16	11	11	81	63	38
Public Acquirer & Subsidiary	45		34	66	63	
Subsidiary & Private Target	11			55		
Subsidiary & Public target	2	0		61		26
Subsidiary & Subsidiary	6			34		
others	3	1	2	77	39	
Total	230	16	128	676	248	98

The initial data set consists of 676 US acquisitions of Indian firms and 230 Indian acquisitions of US firms. This sample includes all the bidding and targets firms irrespective of whether or not the merger was successful. Firms without complete daily return or stock price information are excluded from the sample. As reported in Table 2, this reduces our initial sample to 248 US acquiring firms and 98 Indian target firms, and 16 US target firms and 128 Indian acquiring firms. In our sample all of the subsidiary targets are non-traded firms.

For the cross sectional regression we collect the data on firm characteristics from SDC. There are several Indian firms with incomplete or missing data on SDC. We use DataStream to obtain the data on these firms. Excluding relative size data and the data on percentage owned after transaction, we have complete data on 99 Indian acquirers of US

targets and 129 US acquirers of Indian targets. When we include the percentage owned after transaction our sample has 62 Indian acquirers of targets and 69 acquirers of Indian targets. When we include the relative size variable our sample size falls to 46 Indian acquirers of US targets and 41 US acquirers of Indian targets. We collect the data on the exchange rate from the website of the Federal Reserve Bank of St. Louis.

We compute the announcement date abnormal return on a three day window of -1 day to 1 day after the announcement. We use the standard event-study methodology to analyze the impact of the acquisitions announcement on shareholders' wealth for both acquiring and target firms. We set the event date as the announcement date of the acquisition as reported in the SDC Platinum database.

The abnormal return for stock j on day t (AR_{jt}) is computed using the market-adjusted returns model:

$$AR_{jt} = R_{jt} - E(R_{jt}) \quad (1)$$

where R_{jt} is defined as the raw return of the common stock of the j^{th} firm on day t , and $E(R_{jt})$ is the expected return on stock j . To calculate the expected return on stock j , we use the market model:

$$E(R_{jt}) = \alpha_j + \beta_j(R_{mt}) \quad (2)$$

where R_{mt} is the daily market return using a value-weighted index, α_j and β_j for these firms are computed through a regression of the firm returns on the market returns during the time period of 120 days to 5 days before announcement. For US firms, the daily value-weighted return from CRSP is used as the proxy for the US market return; while for Indian firms, the BSE200 and BSE500 indices from DataStream are used as the proxy for the Indian market returns.⁸

The average abnormal return for day t is calculated as:

⁸ BSE500 started in 1999 so we use BSE200 as a proxy for market index before 1999.

$$AAR_t = \frac{\sum_{j=1}^N AR_{jt}}{N}, \quad (3)$$

where N is the number of firms in the sample. Over an interval of three days beginning with day -1 and ending with +1, the cumulative average abnormal return $CAAR_{-1,1}$ is:

$$CAAR_{-1,1} = \sum_{t=-1}^1 AAR_t. \quad (4)$$

To test the null hypothesis that cumulative average abnormal returns from -1 day to +1 day, is zero, we compute the t statistic (*tstat*) as:

$$tstat = \frac{CAAR_{-1,1}}{\sqrt{\sum_{t=-1}^1 s_t^2 / n}}, \quad (5)$$

where AAR_t is the average abnormal return on day t , s_t^2 is the sample variance of the average abnormal return for day t , and n is the number of firms in the sample.

Our objective is to test if the cumulative average abnormal returns for acquirers or targets are significantly different from zero. We perform the following hypothesis test:

$$H_0 : \mu_1 = 0$$

where μ_1 is the cumulative average abnormal return. We use the t-test statistics of equation (5) to determine the statistical significance of the results.

5. Results

In this section, we analyze the shareholder wealth effects for both acquiring and target firms. We report the cumulative abnormal returns for acquirers and targets during the three day event window of -1 day to 1 day after announcement.

US acquirers and Indian targets

In Panel A of Table 3 we present the CAARs for US acquirers of Indian publicly-traded, privately held and non-traded subsidiary firms. Though the sign on the cumulative abnormal returns around the announcement date is negative, the cumulative abnormal returns for acquiring US firms are not significant. When we split the sample⁹ into the US acquirers of publicly traded, privately held and subsidiary firm Indian target companies, we find the abnormal returns on the announcements of US acquisitions of publicly traded and subsidiary firm targets are statistically insignificant. Shareholders of US firms who acquire privately held Indian firms realize statistically significant abnormal returns of -1.1 per cent on the three day window (-1 to +1).

Table 3: Abnormal returns of acquiring and Indian target firms

Panel A presents the cumulative average abnormal returns for publicly traded US firms that announced the acquisition of Indian target firms. The overall results in column 2 shows negative abnormal returns for the shareholders of acquiring firms. When we separate them into different groups the results show losses for the acquirers of publicly traded, privately held and subsidiary firm targets. In Panel B we present the cumulative average abnormal returns around the announcement date for Indian target firms. Overall results in column 2 show that shareholders of target firms earn significant returns around the announcements of mergers and acquisitions. These results hold even when we separate these targets into being acquired by publicly traded (public), privately held (private) or subsidiary firms.

Panel A: American acquiring firms

	U.S. publicly traded firms acquire Indian targets (248 firms)	U.S. publicly traded firms acquire Indian publicly traded firms (63 firms)	U.S. publicly traded firms acquire Indian privately held firms (83 firms)	U.S. publicly traded firms acquire subsidiaries of Indian firms (63firms)
CAAR[-1,1]	-0.0041	-0.0038	-0.0110*	0.0025

Panel B: Indian target firms

	Indian targets acquired by U.S firms (98 firms)	Indian targets acquired by U.S. publicly traded firms (38 firms)	Indian targets acquired by U.S. privately held firms (34 firms)	Indian targets acquired by subsidiaries of U.S. firms (26 firms)
CAAR[-1,1]	0.0408***	0.0449***	0.0355**	0.0407**

***significant at the 1% level **significant at the 5% level *significant at the 10% level

⁹ We do not study separately the acquirers of government firm targets and joint ventures. These targets are included in the overall sample. For this reason the sum of the acquirers of public targets (63 firms), private targets (83 firms) and subsidiary firm targets (63 firms) is less than the overall sample (248 firms).

In Panel B of Table 3 we present the CAARs for publicly traded Indian targets acquired by publicly traded US firms, privately held US firms and subsidiaries of US firms. We find a significant gain of 4.08 per cent for the set of Indian targets as a whole. When we look at the abnormal returns by the type of US acquirer – publicly traded, privately held or US subsidiary firms we find that the Indian targets realize significant gains of approximately 4 per cent across all types of acquirers for the three day event window.

The above results indicate that the acquisition by any US firm (public, private or subsidiary firm) is beneficial to the shareholders of the Indian targets. The shareholders of US acquirers of Indian targets suffer losses around the announcement of merger and acquisition.

Indian acquirers and US targets

In Panel A of Table 4 we show the CAARs for Indian acquirers of US targets. The acquisition announcement by Indian firms is associated with a 2.71 per cent stock price increases for the Indian acquiring firms. When we decompose the US targets into publicly traded and privately held firms, we find that the Indian firms do not realize statistically significant gains for acquisitions of publicly traded US targets. Indian firms realize a statistically significant gain of 3.09 per cent for the acquisition of privately held US firms and a gain of 2.26 per cent for their acquisition of US subsidiary firms.

In Panel B of Table 4 we report the CAARs of the US targets in the cross-border acquisitions. Our sample size is very small. For the sixteen publicly traded US firms acquired by all types of Indian firms, the US targets experienced large positive abnormal returns but these were statistically insignificant. When we decompose the Indian acquirers into privately held and publicly traded companies, we find large cumulative abnormal returns for the US targets but these are not statistically significant.

These results indicate that Indian acquiring firms realize gains on the announcement of their acquisition of US firms although the gains are concentrated in

acquisitions of privately held or subsidiaries of US firms. No significant gains are earned in the acquisition of publicly traded US companies.

Table 4: Abnormal returns for Indian acquiring and target firms

Panel A presents the cumulative average abnormal returns for publicly traded Indian firms which announced the acquisition of U.S. targets. The overall results in column 2 shows positive abnormal returns for the shareholders of acquiring firms. When we separate them into different groups, publicly traded (public), privately-held (private) and subsidiary firms the results indicate substantial gains for the acquirers of the privately held targets and subsidiary firm targets. Panel B presents the cumulative average abnormal returns around announcement date for the US target firms. The shareholders of target firms gain from the announcement of mergers and acquisitions but this gain is statistically insignificant.

Panel A: Indian acquiring firms

	Indian publicly traded firms acquire U.S. targets (128 firms)	Indian publicly traded firms acquire U.S. publicly traded firms (11 firms)	Indian publicly traded firms acquire U.S. privately held firms (81 firms)	Indian publicly traded firms acquire subsidiaries of U.S. firms (34 firms)
CAAR [-1, 1]	0.0271***	0.0054	0.0309***	0.0226**

Panel B: US targets

	U.S. targets acquired by Indian firms (16 firms)	U.S. targets acquired by Indian publicly traded firms (11 firms)	U.S. targets acquired by Indian privately held firms (4 firms)
CAAR [-1, 1]	0.1812	0.1850	0.0389

***significant at the 1% level **significant at the 5% level *significant at the 10% level

5. Explanations of the empirical results

Public, Private and Subsidiary firm acquirers and Public Targets

Obviously, the shareholders of public targets will agree to sell their perpetual dividend stream and future capital gains when they believe that the future prospects of the company's growth are bleaker than the buyer's beliefs. They would also agree to sell if they get a very lucrative offer from a buyer and there are possibilities for further negotiations of the prize. In either of these cases the merger is good news for the shareholders and should result in positive abnormal returns.

Bargeron, Schlingemann, Stulz, and Zutter (2008) find that the premium paid for acquisitions of public targets is significantly lower when the acquirer is a private firm instead of a public firm. They propose a managerial discretion theory of takeovers where managers may gain from acquisitions that do not benefit shareholders. Due to the private benefits of acquisitions for managers, they pay more for target firms than shareholders

would. Bargeron *et al.* (2007) provide evidence consistent with the managerial discretion theory of takeovers by showing that the difference in target shareholder gains between acquisitions by privately held and by publicly traded firms fall as the proportion of managerial ownership of the publicly traded bidder increases.

Our results are consistent with Bargeron *et al.* (2007) in that we find the abnormal returns for the targets of publicly traded acquirers to be consistently higher than the abnormal returns of targets of privately held acquirers; (a) the abnormal returns for the Indian targets of publicly traded U.S. acquirers are 4.49 per cent (significant at 1% level) and the abnormal returns for the Indian targets of privately held US acquires are 3.55 per cent (significant at 5% level), (b) the abnormal returns of the US targets of publicly traded Indian acquirers are 18.50 per cent and the abnormal returns of the US targets of privately held Indian acquirers are 3.89 per cent, though both of these are statistically insignificant.

Public Traded Acquirer and Publicly Traded, Private and Subsidiary firm Targets

In section 4 we found that shareholders of US acquirers of Indian targets suffered losses on and around the announcement of mergers and acquisitions of Indian companies. However, shareholders of Indian firms gained on the announcement of their acquisition of privately held US firms and subsidiaries of US firms. We investigate if this opposite reactions is due to firm specific characteristics by regressing the three day cumulative abnormal return around announcement (-1 day to +1 day after announcement) on the following firm specific characteristics¹⁰:

- Relative size = Value of deal/market value of acquirer.¹¹ Moeller and Stulz (2004) find that for domestic acquisitions large firms loose when they acquire small firms whereas small firms gain when they acquire large firms. Moeller et al (2004) find

¹⁰ We define these characteristics similar to Conn *et al.* (2005). Due to the limitation of data available on the SDC Thompson data source, we are unable to study all the firm characteristics discussed in Conn et al (2005)

¹¹ Where the data on value of deal is unavailable we e the definition of relative size given by Cakici, Hassel and Tandon (1996) who define relative size as the value of outstanding equity of targets/ equity of bidder.

that small acquirers acquiring large firms have 2 per cent higher announcement returns.

- Acquirer size = Market value of acquirer. Mitchell and Stafford (2000) find that announcement returns are positively related to the size of the acquirer for domestic acquisitions.
- High-Tech = “1” if both target and acquirer are defined as high tech by the SDC Thomson data source and “0” otherwise. Conn *et al.* (2005) find that firms (both acquiring and target) in the same high-tech industry have a positive influence on the returns of the acquirer.
- Related = “1” if target and acquirer have same four digit SIC code and “0” otherwise. This variable measures if the merger is within industry or if the firms are diversifying. Megginson, Morgan and Nail (2004) find that for domestic acquisitions gains are higher in related acquisitions.
- Value = “1” if acquirer’s market to book value of equity is in quintile one and “0” otherwise
- Glamour = “1” if acquirer’s market to book value of equity is in quintile five and “0” otherwise. These definitions of value and glamour variables are from Conn *et al.* (2005)
- TQ = Tobin q of the acquirer. We estimate Tobin’s q as the market value of firm divided by the book value.
- Downer= Dummy equals 1 if the majority stake is acquired (greater than 50%) and 0 otherwise. Chari *et al.* (2010) find that acquirers from developed world gain when they announce acquisition of majority stake in firms from emerging world.
- DAQC = “1” if the acquirer is from A and “0” if the acquirer is from India.

We provide the summary statistics by cross-border relationship for the above variables in Table 5. We find that the Indian and the US acquirers of private targets have similar high tech stat levels. The Indian acquirers of publicly traded US targets and US subsidiary firm targets are more often classified as high tech stat as compared to US acquirers of publicly traded Indian firms and Indian subsidiary firm targets. Irrespective of the target firm stat, Indian acquirers appear to engage in company diversification more than US acquirers. The relative size of the targets is substantially smaller for US acquisitions. The market value of Indian acquirers of US targets is also significantly lower than the market value of US acquirers of Indian targets. Though the average percentage owned after the transaction by Indian acquiring firms is higher than the

percentage owned after the transaction by acquirers, both Indian and acquirers, acquire majority stakes in the target firms. For both and Indian acquirers, the average stake acquired in the private and subsidiary firm targets is higher than the average stake acquired in publicly traded targets.

Table 5: Summary statistics of the US and Indian acquiring and target firms

In Panel A we present the summary statistics for the Indian acquirers of US targets and in Panel B we present the summary statistics for the US acquirers of Indian targets. A comparison of Panel A and Panel B shows that the relative size of US targets is substantially higher than the relative size of Indian targets and the US acquirer have higher market value than the Indian acquirers. The Indian acquirers of the US targets diversify their business more than the U.S. acquirers of the Indian targets.

Panel A: Indian Acquirer of US Target			
	Publicly traded target	Privately held target	Subsidiary target
High Tech	0.583	0.532	0.500
Related	0.250	0.274	0.308
Market Value of Acquirer (\$Million)	2238	835	1185
Market Value/ Book Value of equity	10.739	4.464	4.980
Acquirers book value of common equity (\$Million)	171	210	260
Acquirer total assets (\$Million)	292	377	508
# of firms above data is available for	11	62	26
average % owned after transaction (OAT)	75.75	88.82	99.71
OAT data available for (# of Firms)	4	41	17
Relative size	0.362	0.110	0.481
Relative size data available for (# of Firms)	9	27	10
Total Number of Firms	16	110	45
Panel B: US Acquirer of Indian Target			
	Publicly traded target	Privately held target	Subsidiary target
High Tech	0.264	0.558	0.273
Related	0.415	0.349	0.394
Market Value of Acquirer (\$Million)	52523	6143	32489
Market Value/ Book Value of equity	7.349	7.214	4.465
Acquirers book value of common equity (\$Million)	14066	2093	6965
Acquirer total assets (\$Million)	135979	5381	34739
# of firms above data is available for	53	43	33
average % Owned After Transaction (OAT)	50.3	84.24	79.87
OAT data available for (# of Firms)	21	28	20
Relative size	0.016	0.027	0.006
Relative size data available for (# of Firms)	19	12	10
Total Number of Firms	81	88	66

We regress the CAAR for the acquirers of public, private and subsidiary targets on these variables to investigate whether there are abnormal return differences to the acquirer's home country after controlling for firm characteristics. The data for relative size and percentage owned after transaction is available for fewer firms hence for each of the target types we first run the regression without the variables, 'relative size' and 'Downer' as the lack of data on these variable substantially reduces the sample size. We use the following three models to test if the CAARs are country dependent:

Model I:

$$CAAR_i = \alpha + \beta_1 HighTech_i + \beta_2 Related_i + \beta_3 LMV_i + \beta_4 TQ_i + \beta_5 Value_i + \beta_6 Glamour_i + \beta_7 DAQC_i + \beta_8 EXC_i + \varepsilon_i \quad (6)$$

Model II:

$$CAAR_i = \alpha + \beta_1 HighTech_i + \beta_2 Related_i + \beta_3 LMV_i + \beta_4 TQ_i + \beta_5 Value_i + \beta_6 Glamour_i + \beta_7 DAQC_i + \beta_8 EXC_i + \beta_9 Downer_i + \varepsilon_i \quad (7)$$

Model III:

$$CAAR_i = \alpha + \beta_1 HighTech_i + \beta_2 Related_i + \beta_3 LMV_i + \beta_4 TQ_i + \beta_5 Value_i + \beta_6 Glamour_i + \beta_7 DAQC_i + \beta_8 EXC_i + \beta_9 RelativeSize_i + \varepsilon_i \quad (8)$$

where *LMV* is the log of market value of the acquirer. *EXC* in the above equation is the exchange rate variable¹² which measures the effect of changes in exchange rate on mergers and acquisitions. We follow Cakici Hassel and Tandon (1996) who estimate the effects of exchange rate variable on bidding shareholders' wealth as a result of foreign acquisitions of US firms, and compare these to a control sample of foreign acquisitions by US firms.

¹² We compute the exchange rate variable using the method adopted by Cakici, Hessel and Tandon (1996). We take the Indian currency's average exchange rate (per dollar) for the sample period 1995-2007 and subtract the Indian currency's exchange rate for the year of acquisition. Then we divide this difference by the average exchange rate.

We pool the country data and run the above regression models for the acquirers of publicly traded, privately held and subsidiary targets separately. The results are reported in Table 6. For the acquirers of publicly traded and subsidiary targets we find an insignificant DAQC variable suggesting that there is no country difference in the abnormal returns of the Indian and US acquirers of the publicly traded and subsidiary targets.

Table 6: Regression results of cross border mergers and acquisitions

In the following table we present the regression on the CAAR (-1 day to +1 day after the announcement) as dependent variable for the acquirers of public, private and subsidiary targets. After controlling for firm characteristics we find that the dummy variable for country (DAQC=1 for US acquirers and DAQC=0 for Indian acquirers) is negative and significant for the acquirers of private targets suggesting a lower abnormal return for the US acquirers as compared to the Indian acquirers of private targets.

Variable	Public Target			Private Target			Subsidiary Target		
	I	II	II	I	II	II	I	II	II
Intercept	-0.030	-0.017	-0.020	0.037*	0.041	0.067	0.017	0.064	-0.017
HighTech	0.009	0.026	0.020	0.009	0.002	-0.001	-0.002	0.001	0.063***
Related	-0.001	-0.013	-0.034*	0.003	0.014	0.005	-0.003	0.008	-0.008
LMV	0.005	0.007	0.004	-0.001	-0.002	-0.002	0.002	-0.001	0.004
TQ	0.001	-0.005	0.000	-0.001	0.001	-0.002	0.000	0.000	-0.005
Value	0.022	-0.008	0.071**	-0.001	0.000	-0.006	0.021	0.019	0.018
Glamour	-0.004	-0.010	0.014	-0.006	-0.034*	0.019	-0.036	-0.011	-0.003
EXC	0.045	0.088	0.038	0.058	-0.121	0.181	0.070	-0.011	0.197
DAQC	-0.019	-0.006	-0.014	-0.044***	-0.053***	-0.044*	-0.020	-0.024	-0.014
Relative Size			-0.105*			-0.024			0.028***
# of firms	65	25	28	104	69	38	59	37	20
Rsquare	0.095	0.266	0.401	0.196	0.197	0.197	0.146	0.232	0.786

The coefficient for the sample of publicly traded acquirers of privately held targets is negative and significant suggesting a lower CAAR for the US acquirers of privately held Indian targets as compared to the Indian acquirers of privately held US targets.

6. Conclusion

Prior empirical research on mergers and acquisitions is predominantly related to the developed markets of the US and Europe. There is limited work on mergers and acquisitions when targets from developed world are acquired by companies from developing world. In the cross border mergers and acquisitions between developed and developing world firms, researchers have studied the effect of announcement of mergers

and acquisitions on the acquirer firms only. None of the studies to date have investigated the effect of announcement of mergers and acquisitions on the target firms. In this paper we study the cross border mergers and acquisitions between the U.S. and India for both acquirers as well as target firms.

We use data on mergers and acquisitions from January 1995 to August 2007 and find that the mergers and acquisitions with US acquirers and Indian targets result in significant losses for acquirers and significant gains for the targets. Mergers and acquisitions between Indian acquirers and US targets result in significant gains for the acquirers and insignificant gains for the targets, and mergers and acquisitions between Indian acquirers and Indian targets profits both the acquirers and the targets.

We further examine the abnormal returns by decomposing the sample of firms into publicly traded, privately held and non-traded subsidiary firms. We find that the US acquirers of publicly traded Indian firms realize insignificant losses while publicly traded Indian targets acquired by US firms earn significant returns on the announcement of a merger or acquisition. Indian acquirers of publicly traded US firms earn insignificant gains/losses and US targets of publicly traded Indian acquirers earn insignificant positive abnormal returns on the announcement of mergers and acquisitions. These results are similar to the results we find in the existing literature.

In the cross-border acquisition of private targets, publicly traded US acquirers suffer losses whereas publicly traded Indian acquirers realize gains. The Indian acquirers of US subsidiary firm targets realize significant gains while the U.S. acquirers of Indian subsidiary firm targets realize insignificant gains/losses. We investigate these cross-border merger and acquisition results to determine if the results are due to firm characteristics or are country dependent by regressing the cumulative abnormal returns on the firm characteristics and a dummy variable for the country of acquirer.

For the private targets, we find the country dummy variable to be significant after controlling for firm characteristics indicating a lower abnormal return for US acquirers of privately held Indian firms as compared to the Indian acquirers of privately held US firms. The dummy variable is not significant for the acquirers of publicly traded firms

and for subsidiary firm targets indicating that firm characteristics and not the country environments governs the returns on these mergers and acquisitions.

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