

**Jumping Over the Border, Why Not?**

**Examining the Advantages and Disadvantages of International Acquisitions**

**Compared to Domestic Acquisitions**

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## **Abstract**

This paper revolves around the exploration of the unique advantages acquired through international acquisition. International acquisition in this research includes mergers, acquisitions, and joint ventures. Market extensions and conglomerate mergers are strategic steps for companies to expand their markets and investment. Buying other companies, with the appropriate considerations being given to corporate structure, may be the easiest step for a company to grow. However, acquisitions can result in an expensive disaster if they are not done correctly. This is due to many factors; among these are the irreconcilable differences between the two corporate cultures of the parent and the subsidiary company. The decision to acquire, therefore, can be tricky and needs to be carefully considered.

The dilemma of whether or not to buy a company leads to another question: what if the subsidiary is outside of the U.S.? Would it add another layer of difficulty on to the acquisition question? Or would it open more doors and give the parent company unforeseeable competitive advantages? Many transitioning economies in the Southeast Asia region, such as Vietnam or Singapore, are stepping in the path of developed economic powers, such as the U.S. While these countries gravitate towards a capitalistic, industrialized society, they often lack technology advances due to insufficient funding for research infrastructure. The world is getting smaller than ever due to the exponential growth of the Internet and social media. These two factors alone increase the demand for U.S. products and services. International expansion may be worth all the trouble for some companies.

This research is done by compiling peer-reviewed sources on the topic of international acquisitions.

## **Jumping Over the Border, Why Not?**

### **Examining the Advantages and Disadvantages of International Acquisitions Compared to Domestic Acquisitions**

International acquisition, in this particular research, is defined as the act of partnering with, or acquiring a company that is located outside of the parent company's national borders. This act implies the implementation of integrated management and knowledge transfer between the involved companies. The term acquisition in this paper includes mergers, joint venture, and acquisitions. Even though the topic of acquisition is not new, buying a company entails many uncertainties and risks, both predictable and unforeseeable, such as corporate synergy. Regardless of acquisition types, having a difference between corporate cultures can render the acquisition a very expensive and even detrimental mistake. In the case of AOL and Time Warner Cable, the employees, company officials included, were struggling to integrate because the working styles and company visions of AOL and Time Warner Cable created an irreconcilable difference. An AOL official confessed: "Being a part of a giant corporation, a conglomerate, was not particularly appealing to me. We would just be part of a big corporation that controlled half the media in the world" (Klein, 2004). From the Time Warner Cable's side, things were not any better. When asked about the "honeymoon period" of the AOL/TWC marriage, a TWC executive said: "If there was a honeymoon period, it was about as short as summertime in Minnesota" (Klein, 2004). For the companies' executives, the acquisition initially made perfect sense as the combination of cable and Internet would surely give birth to an entertainment giant: "AOL Time Warner,

as the new company would be named, would use its vast array of media assets – from movies to magazines to music to the Internet – to create a new way to promote its own products and services, cut costs, and generate new forms of revenue” (Klein, 2004). Unfortunately, an acquisition’s success requires much more than just market research and an agreeable acquisition price. Over time, TWC realized their decision to acquire AOL would turn out to be a painful and expensive, business write-off.

What needs to be noted in this case is that AOL and TWC are both American corporations. They operate in the same market and culture, offer related services, and serve relatively the same category of customers. Yet, they could not work together to build an empire as TWC had imagined. Then why would anyone, after studying this case, even consider taking it a step further and integrating with a company that does not speak the same language, has roots in a completely different culture, and is located thousands of miles away? The answer is: it depends.

### **Literature Review:**

Researchers in the topic of international acquisition mostly concentrate on finding a universal formula to a “happily ever after” merger. While none of them has found a single secret to world domination, they all agree that a successful acquisition is a combination of right moves, namely adequate market research, prior experience, strategic fit, cultural fit, and integration process (Duncan & Mtar, 2006; Meschi, 2004 , Colombo et al., 2007). However, before analyzing these factors, one should take a step back to the question above: why would anyone consider working with an unknown company outside the borders while there are domestic companies who offer the same service? This question is often neglected or only briefly

mentioned in the literature. International acquisition is an interesting concept that entails many distinct differences, compared to domestic acquisition, such as management philosophies, cultural differences, innovations, work ethics, and opportunities to expand (Errunza & Senbet, 1981; Caves, 1971, Zhan et al., 2008; Bresman et al., 1999). The purpose of this research is to explore the advantages and disadvantages of international acquisitions, compared to domestic acquisitions. Because each and every country possesses unique historic, economic, political and social differences, it is impossible to draw a general conclusion about all international acquisitions. Due to the scope of this paper, the main focus is to identify the unique advantages of international acquisition and particularly to encourage cross-border international joint ventures of North American companies in developing economies in Asia.

**Hypothesis 1: International Acquisition is positively perceived by financial analysts.**

Although globalization has received increased attention in the last ten years, and the explosion of social media began only several years ago, companies have long looked beyond their borders: “U.S. acquisitions of foreign firms increased in value from \$1.5 billion in 1979, to more than \$14 billion in 1989. These acquisitions have been rationalized as necessary strategic investments that allow American firms to position themselves in the global environment of the 1990s” (Markides and Ittner, 1994). According to United Nations Conference on Trade and Development (UNCTAD) statistics, collected in 1998: “During 1991-1997, 94% of the regulations regarding FDI (foreign direct investment) were relaxed to promote FDI in both

developed and developing countries” (Lahiri et al., 2003). Two years later in 2000, UNCTAD announced: “The value of all M&As (cross-border and domestic) as a share of world GDP has risen from 0.3% in 1980 to 8% in 1999” (Kayalica et al., 2009). Witnessing first-hand the boom in international acquisitions at the earliest stage, Markides and Ittner took part in the confusing, contradictory research about the effects that international acquisitions have on shareholders, with a study of 276 U.S. international acquisitions between 1975 and 1988 to determine the values they bring to companies. With stock price being the main measurement, Markides and Ittner found: “on average, foreign acquisitions create shareholder value for acquiring firms, a result that is consistent with the proposition that international acquisitions are associated with net benefits” (Markides and Ittner, 1994), compared to domestic acquisitions. Six years later, Loree, Chen and Guisinger (2000) published a similar conclusion about international acquisition: “ According to our findings, analysts are likely to raise their earnings estimates in response to the announcement of an international acquisition, all other things being equal, for companies that have demonstrated previous experience in performing this type of strategy” (Loree et al., 2000). Over the course of six years from 1994 to 2000, financial analysts modified their opinion about international acquisitions from merely “much better news than domestic acquisitions” (Markides and Ittner, 1994) to “analysts react to the acquisition characteristics in ways that are somewhat more complex than we imagined” (Loree et al., 2000). In Loree’s research, analysts are cautious in evaluating international acquisitions because history has provided an adequate amount of failed acquisitions for them to be careful when delivering their

opinions. The factors that tend to sway stock analysts towards a positive evaluation include: international acquisition experience, country experience, relatedness of the acquisition's business, experience with general acquisition and diversification versus focus (Loree et al., 2000). In addition, another study by researchers at University of Central Florida takes it further to include geographical, economic and political settings as influencing factors: "We find that the market reaction is more favorable when U.S. firms establish joint ventures in Asian countries, less favorable when the joint venture is established in lower risk developing countries, and less favorable when the joint venture is a manufacturing operation" (Borde et al., 1997).

There is no doubt that investors and stockholders' decisions are somewhat influenced by financial analysts (Loree et al., 2000; Borde et al., 1997). As these independent studies show, a company that is "international seasoned" with certain conditions, such as having experience in working in a global setting, preferably Asia, look better under the analysts' radars. According to a managerial study by Bresman, Birkinshaw and Nobel, this is because of the unique opportunities than can only be experienced by taking a leap across national borders (Bresman et al., 1999).

### **Hypothesis 2: International Acquisition creates unique synergies and competitive advantages**

From an external point of view, international acquisition can have a positive impact on its participants in the stock market. The base for analysts' optimistic evaluations stems from internally proven success. Not every international acquisition is guaranteed to succeed, as in the case with domestic acquisitions. However, success that is derived from an international setting has such unique



characteristics that it can create critical competitive advantages to the involved parties. Among potential positive effects, supporters of international acquisition tend to emphasize several advantages: reduction of variability of acquirer's earnings, international diversification, economies of scale, international market share, immediate expansion, critical mass, reverse knowledge transfer, and a favorable competitive environment (Borde et al., 1998; Yu et al., 1992; Duncan et al., 2006).

Examining the cross-border acquisition of Ryder Transportation (US) by FirstGroup, the UK's largest player in the public transportation industry, Duncan and Mtar (2006) reach several conclusions regarding the benefits derived from the successful example. First, the acquisition gave FirstGroup a valuable and powerful market entry to the U.S.: "By acquiring the second largest player in the US school bus industry and positioning itself in a market with significant growth potential, FirstGroup has enhanced its market power, which in turn enables it to compete more effectively in the increasingly global public transport industry" (Duncan & Mtar, 2006). For the US's side (acquiree), FirstGroup has brought "extremely beneficial" management skills to the acquired firm, especially when "the US market is now evolving along a similar path as the UK". Moreover, Ryder (the US acquiree), transferred to its parent a surprised competitive advantage: "the reverse transfer of know-how has resulted in the creation of new business opportunities for FirstGroup and enhanced its core business" (Duncan & Mtar, 2006). Specifically, FirstGroup implemented the signature US yellow school bus system, which was unprecedented in the UK, giving the parent company a tremendous competitive advantage in the

public transportation industry in its home country. It should be noted that not every international experience is the same and a blind international partnership can be as disastrous as a domestic one. Every country and region possesses its own culture and working habits, giving the parent an array of opportunities for the company to identify, and turn into assets. In the case of FirstGroup and Ryder, both of the companies are located in developed economies where they possess similar values and cultures, due to a shared history and frequent international relations. While this particular circumstance certainly helps them connect and learn from each other, it leads to a question of whether or not entering a developing economy can be considered a viable option.

Contrary to popular belief, Kayalica et al. (2009), Waheed et al. (1995) and Borde et al. (1998) argue that investing in risky, restrictive, developing countries generates more advantages to those who can get pass entry barriers, due to limited competition. Taking advantage of the local government of the target country is one of the unique attributes of international acquisition since “National governments can encourage or discourage foreign investors in a discriminatory manner by choosing the policy tools that do not have a direct effect on international trades” (Kayalica et al., 2009). Because of this observation, researchers have focused on analyzing, testing and mapping a possible pattern to predict how a government would act in order to dilute the possibility of oligopoly. In particular, Kayalica et al. (2009) found that “[in] the absence of any policy towards domestic firms, the optimal lump-sum profit subsidy to foreign firms is negative. A domestic merger will increase the number of foreign firms if the optimal subsidy is exogenously given”

(Kayalica et al., 2009). In another study, Lahiri (2003) discovered that “ in the presence of lobbying, an increase in the number of domestic firms or an increase in the degree of corruption decreases the discriminatory subsidy towards FDI” (Lahiri, 2003). These are some of the conclusions in the topic of foreign direct investment in relation with target governments. They both show that a country’s political infrastructure and economic setting (developing versus developed) can pose either a threat or opportunity for foreign investment. This is confirmed by several separate studies, including Pierre-Xavier Meschi (2004) in France, Dikova et al. (2010) and Duncan et al. (2006) in the U.S. These authors even list knowledge about the target country as one of the success determinants.

**Hypothesis 3: Breaking the doors into a transitioning economy, such as Vietnam, through joint ventures is needed and rewarding**

The reason for the conclusion of “ventures in Asia generate more favorable wealth effects” (Borde et al., 1998) is not the relative strength of the U.S. dollar, venture partner, or the financial strength of the parent company (Borde et al., 1998). Surprisingly, it is because most Asian countries, such as China, India, and Vietnam, are transitioning economies. Generally, most studies have found that developing, especially transitioning economies highly favor international acquisition. As defined by Zhan et al. (2009), “transition[ing] economies are moving from closed-market, command structures to open, capitalistic systems.” These economies typically transition from government-controlled activities to free-market competition, and are in need of “technological, managerial, and marketing capabilities to meet the growing competition” (W.Zhan et al., 2009). Teaming up

with international companies from developed economies through international acquisition, especially international joint ventures, is one of the most effective ways to compete in transitioning economies (Zhan et al. 2008; Child, 2001; Shipley et al., 1996). This confirms one of the hypotheses of this paper: international joint venture is the easier, more frequently chosen way to enter a transitioning economy, such as Vietnam: “The IJVs’ acquisition of such knowledge should enable them to perform better than domestic firms in the increasingly market-oriented systems” (Tsang et al. 2004).

### **Conclusion, Suggestions, and Limitations:**

Business leaders have long known that acquisition is more than “one plus one equals two.” It is capable of delivering much more than what individual companies can achieve alone. Choosing the right partner and managing the post-acquisition process are challenging but crucial to the success of an acquisition. This is why researchers on this topic have long looked into determinants of acquisition success. As the world is getting smaller because of technology advancement, language barriers and cultural clashes remain an unavoidable burden in international business. Nonetheless, international acquisitions, mergers and joint ventures included, is a strategic move because of the undeniable advantages it can bring. These advantages include, but are not limited to, positive review from stock analysts, reduction of variability of earnings, gain on international diversification, economies of scale, international market share, immediate expansion, critical mass, reverse knowledge transfer, and a favorable competing environment (Borde et al., 1998; Yu et al., 1992; Duncan et al., 2006). The topic of how to achieve success

through acquisition is applicable and similar to both domestic and international cases (Duncan & Mtar, 2006). The ultimate decision to stay within the borders or jumping over them is a tricky, but possibly rewarding one. Like most business decisions, doing business overseas has its own risks and rewards. Although not discussed in detail in this research, it is suggested that adequate research prior to acquisition and focused post-acquisition management are two of the most important determinants of success for international acquisition. Limitations of this research include lack of real-world cases and updated references.

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