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The concurrent impact of cultural, political and spatial distances on international Mergers and Acquisitions

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1. OBJECTIVE

The objective of this study is to explore the concurrent effect exerted by cultural, political and spatial distances on the flows of Merger and Acquisitions (M&A) deals occurred between any two countries belonging to the whole European Union (27 States) or to the European Neighbors group (16 States) over the period 2000-2011. The existing literature on international M&As shows that distances have an important effect on the development of firms strategy because the extent of similarity between countries, based on their legal, economic, administrative, political, and cultural institutions are important factors that affect M&A strategy. Firms have a greater opportunity to benefit from international exchanges when the cross-national institutional distance between the home and host countries is small because information asymmetries and overall transaction costs are lower.

More specifically, we investigate the role that distances play in determining the M&A activity by analyzing the drivers of both the probability of observing a cross-country economic and business interaction and the intensity of such interactions.

This is accomplished by adopting the class of econometric models that allows to estimate simultaneously the two processes while exploiting the informative potential of a highly differentiated set of countries, comprising advanced economies, new EU member states, Eastern Europe, and Mediterranean Africa.

In the case of EU and ENC countries the analysis of M&A activity, being one of the most important forms of international exchanges, is expected not only to enhance the understanding of its main determinants, but also to provide useful insights on the ongoing process of political and economic integration between the two groups of countries.

2. MAIN RESULTS

The empirical analysis is based on the estimation of zero-inflated negative binomial (ZINB) models, which enable us to simultaneously model the probability that an M&A deal occurs between any two countries and the rate of recurrence of the deals. The high flexibility of the zero-inflated negative binomial (ZINB) models allows us to distinguish, on substantive grounds mainly related to firms' behavior, the set of variables that enter the probability part of the model from the set of regressors that should more reasonably be included in the rate of recurrence part of the model.

We hypothesize that cultural, institutional, and political differences are crucial in determining whether firms are willing to initiate economic interactions. If countries share common and recognized characteristics along those 'intangible' dimensions, the necessary conditions to consider engaging in a business deal are satisfied; otherwise, the 'dissimilarity' costs are excessively high and exceed any potential benefit arising from the deals. In our sample, a striking example is presented by country pairs including Israel and one of the southern EU neighboring countries (Algeria, Egypt, Jordan, Lebanon, Libya, Morocco, Syria, or Tunisia). In these cases, the observed zero values are more likely to be the result of the well-known historical and political distances that have prevented, or significantly limited, the occurrence of stable and trustful economic and political relationships between Israel and most of the other southern Mediterranean countries.

Therefore, the probability process is modeled as a function of the complete set of distances - geographical, cultural, institutional (based on the WB governance indicator) and the 'Israel dummy' - as well as of pure socioeconomic indicators (population and GDP per capita) and the two EU dummies for both acquirer and target countries. The count process for the rate of recurrence is specified as a function of the population and GDP per capita of both the acquirer and the target country, the target country's per capita GDP growth rate and technological level; among the distance measures only the geographical one is included to account for transport costs. The main results indicate that the probability of observing an M&A deal is positively related to the relative masses (population) and the economic development level (GDP per capita) of the acquirer and target countries, while it is negatively related to all distance measures. In essence, if two countries are very distant in terms of spatial, cultural, and institutional dimensions, the probability that they will not conclude a bilateral deal is high.

We find that the acquirer country's level of economic development is a very important determinant of the intensity of M&A deals for the acquirer, while population is relatively more influential in the target country. Its technological level acts as a relevant and attractive feature for potential acquirers, whereas the target's economic outlook (GDP per capita) rate of growth does not seem to provide any additional contribution. These main results are confirmed by an extensive robustness analysis.

3. POLICY IMPLICATIONS

The relationships between the EU and ENC countries have received great attention since 2007 when the EU has attempted to develop an integrated policy towards the non-candidate countries on the EU's eastern and southern borders as an alternative to further enlargements. Among the different ways in which valuable interactions between the EU and ENC are generated, capital transactions represent a key channel and M&A activity is one of the most effective ways for directing capital towards

productive sites. Therefore, from a policy perspective our results, by enhancing our understanding of the determinants of M&A activities among EU and ENC countries, provide useful insights to assess whether the European neighbouring policy (ENP) is becoming effective in offsetting tangible and intangible barriers between the two country groups.

More specifically, the relative political-institutional distance measures employed in the empirical analysis indicate that countries like Belarus, Libya, Syria, Azerbaijan, Russia, Ukraine, Moldova, Egypt, Jordan rank very low in terms of democracy, human right, rule of law, good governance and market economy principles, whereas top positions are taken by the most advanced EU countries, namely Sweden, Denmark, Finland, The Netherlands, Austria.

Notwithstanding the merits of the ENP and the goals achieved so far, the reported “distances” indicate that there is plenty of unfulfilled potential in the relationships between the EU and the ENC countries.

This calls for more efforts from both sides in order to accelerate the process of ENC democratic reform and thus reduce the existing gap in democracy and human rights values. Increased financial assistance and technical support from the EU side and stronger actions towards democratic control, political and civil liberties, competitive elections, freedom of organization and freedom of expression, fight against corruption and violence from the ENC side are expected to improve the level of cooperation, to increase economic integration and people movements, to make ties closer and to strengthen peaceful relationships. Ultimately, this enduring process should guarantee widespread democratic shared values, indispensable for civil and political stability, sustainable long run development and economic prosperity.