Guest Editorial: Institutional role, the Market for corporate control and Firm performance

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Abstract

The research theme "the market for corporate control and firm performance" has been received a great attention from economics and management scholars, especially since the UNCTAD's report on 'transnational corporations and investment patterns across the world'. The impact of quality of formal institutions on the market for M&A (negotiation and post-merger stages) is missing in the current literature. In a modest way, recent studies have drawn attention to economic nationalism and political environment in cross-border acquisitions representing both developed and emerging markets. Scholars argue that formal institutional characteristics such as legal framework, judicial system, and political factors have serious impacts on the success of negotiations, especially in the international setting. Motivated by these factors, the special issue aimed to study the relationship between institutional role and the performance of firms participating in local and foreign deals. The special issue call for papers has received a good response from finance and strategy researchers globally. Following double blind review system, we have accepted seven papers for the Issue in 2017.

Keywords: Institutional role, Market for corporate control, Firm performance

1. Theoretical background

The research theme "the market for corporate control and firm performance" has been received a great attention from economics and management scholars, especially since the UNCTAD's (United Nations Conference on Trade and Development) report on 'transnational corporations and investment patterns across the world'. For example, according to McKinsey reports, the worldwide market value for local and overseas mergers and acquisitions (M&A) has significantly increased from US$3 trillion in 1999 to US$4.5 trillion in 2007, then further rose by US$5 trillion in 2015. Though, it is important to note that the 2007-2009 global financial crisis has a significant negative effect on the cross-border M&A market across countries, continentals and industries (see Rao and Reddy, 2015). At the same time, emerging economics such as Brazil, Russia, India and China (BRIC) have reported not only inward direct investment but also outward direct investment through acquisitions (Reddy, Li and Xie, 2015). This immense market response is mainly due to ongoing institutional policy reforms, local market development, and globalization of government-controlled industries (Bruton et al., 2015; Lebedev et al., 2015). Regarding performance effects, mergers and acquisitions have significant impact on various aspects of firm performance, including accounting performance, marketing, operational excellence and human capital. Extant reviews have argued that corporate acquisitions destroy firm's value while benefiting the target firm shareholders, and this will apply even more when a firm participates in a cross-border deal (Ferreira et al., 2014; Haleblian et al., 2009; Martynova and Renneboog, 2008; Reddy, 2014).

A common argument is that developed countries have better legal, economic and accounting practices while developing countries have not. Studies have found that a country with a liberalizing environment usually attracts a higher flow of investments from the rest of the world due to better investor governance and capital protection measures (Bris and Cabolis, 2008; Erel et al., 2012). A friendly, superior institutional environment not only improves economic performance but also determines the market for corporate control activities such as mergers and acquisitions (North, 1990; Peng, 2003). On the other hand, lower economic development and poor quality of formal institutions in the country have adverse effects on the inflow of overseas capital flows, in which the country reports a smaller amount of investments (Lucas, 1990). Therefore, it is logical to study the impact of formal institutional environment on the market for corporate control and firm performance.

Yet, the impact of quality of formal institutions on the market for M&A (negotiation and post-merger stages) is missing in the current literature. In a modest way, recent studies have drawn attention to economic nationalism and political environment in cross-border acquisitions representing both developed and emerging markets (Ketkar, 2012; Scott-Kennel, 2013; Wan and Wong, 2009; Witt and Lewin, 2007; Zhang and He, 2014). Scholars argue that formal institutional characteristics such as legal framework, judicial system, and political factors have serious impacts on the success of negotiations, especially in the international setting. Motivated by these factors, the special issue aimed to study the relationship between institutional role and the performance of firms participating in local and foreign deals.

2. Special Issue Papers

With this theoretical background, the special issue welcomed scholars to submit their research on various themes in the market for corporate control, including institutions, market for corporate control and firm performance, public administration role in corporate control transactions, cross-border acquisitions and firm performance, role of private equity firms in acquisitions, institutional role and the internationalization process, and diversification, corporate governance and firm performance, among others. The special issue call for papers has received a good response from finance and strategy researchers globally. Following double blind review system, we have accepted seven papers for the Issue in 2017. A summary of papers in this special issue is presented below.

Miah and Uddin (2017, this issue) in their paper titled, 'Hostile takeover in Japan: institutional constraints and change' critically analyze a takeover battle between Livedoor and Fuji TV in Japan. The authors explore how does a merger/acquisition conflict between two key players in the industry affect national corporate governance and takeover institutional policies. They suggest that although the takeover battle has insignificant effect on the ownership and governance of industry peers, it has a considerable impact on takeover policies during post-Livedoor era in Japan, especially the policies pertaining to acquisition of local companies by foreign firms.

Duppati, Rao and Locke (2017, this issue) in their paper titled, 'Are the Indian corporates creating value through acquisitions in the US and European markets?' examine short term (average abnormal returns) and long term effects (cumulative abnormal returns, buy-and-hold abnormal returns) of cross-border acquisition announcements by Indian firms. Although overall results show positive effects around acquisition announcements, specific firm-level observations indicate mixed results in the short term. Then, the authors specially analyze four cases that reported differing outcomes, such as Tata Steel, Hindalco, Dr. Reddy's and Wockhardt. The announcement and post-acquisition operating performance results suggest that Indian corporates acquired competitive ownership advantages through the outward foreign direct investment related M&A deals.

Bhatia and Thakur (2017, this issue) in their paper titled, 'Choice of diversification strategies in an emerging market environment: an empirical evaluation' empirically test the nature, extent and pattern of diversification of local companies with firms having international operations. To do so, the authors apply Jacquemin-Berry entropy index to a sample of 536

Indian manufacturing firms over three intervals, 2001, 2006 and 2011. Findings suggest that firms with purely domestic operations are more likely to adopt a forward-pattern of diversification, and local and multinational firms are likely to opt for related diversification over extreme choices of diversification, though local firms represent larger extent of diversification.

Sinha (2017, this issue) in the paper titled, 'Public sector general insurance companies in India: potential gains from merger' examines the potential consequences of merger of two public sector general insurance companies in India using data envelopment method. Results derived from efficiency gains and decomposition effects indicate that the overall potential gain from the merger is negative due to the presence of negative scale effect. The paper contributes to institutional transitions in India and how these institutional changes affect corporate consolidation strategies such as mergers and acquisitions in government-dominated general insurance industry.

Kansil and Singh (2017, this issue) in their paper titled, 'Impact of foreign shareholdings on corporate governance score: evidence from Bombay Stock Exchange, India' empirically test the impact of foreign shareholdings on corporate governance of firms listed on Bombay Stock Exchange, India. Using a sample of 201 firms, the authors find that the impact of market capitalization, size and age on corporate governance score is significant for firms with non-controlling stake of foreign shareholders. However, the non-controlling stake of foreign shareholdings affects corporate governance as against the controlling stake. This suggests that when foreign shareholders buy larger stakes, they favor weak governance because it allows them to exploit minority equity stakes.

Falahat and Migin (2017, this issue) in their paper titled, 'Export performance of international new ventures in emerging market' study the relationship between international market orientation and export performance of international new ventures. Drawing insights from resource-based view, the authors examine a sample of 223 international new ventures in Malaysia. Key findings indicate that firm-level development strategies such as low cost and differentiation have positive and mediating effects on export performance, while international market orientation has insignificant effect.

Mishra (2017, this issue) in the paper titled, 'Volatility and calendar anomaly through GARCH model: evidence from the selected G20 stock exchanges' analyzes the day of the week pattern of market returns and volatility in selected G20 stock markets during the period 2009-2014. Using GARCH models, the author finds that some calendar anomalies are persistent in the stock return pattern, and the day of the week effect shows positive results for emerging stock markets. In case of volatility patterns, a few markets reveal that volatility is greatly increased after a negative return. This suggests that investors require being more cognizant about the negative news than the positive news in the market.

3. Future research themes

There are several avenues for improving the current literature on the market for corporate control and firm performance in developed and emerging economies. For example, do changes in the ruling political party and new government formations favor the market for corporate control deals? How does a bilateral trade agreement between the host and home countries affect direct international investments and acquisitions? Are friendly relations, equal economic status, similar cultural attributes and sharing the same continent really an issue in border-crossing investments? Specially, studies that examine ‘general elections, new government formation and the market for corporate control, role of regulatory and political factors that affect the success of foreign deals, and international equity joint ventures and corporate performance’ in emerging economies would add significant knowledge to the current literature (see Zhu and Zhu, 2016). Further, studies that conduct comparative analysis and longitudinal case analysis relating to the institutional theme are most sought (see Reddy (2015) for conducting case study research in emerging markets using archival sources).

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