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China's Cross-border Mergers and Acquisitions: A Contextual Distance Perspective

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INTRODUCTION

Outward foreign direct investment (OFDI) by Chinese firms has received considerable research attention recently (Li, Cui, & Lu, 2014; Lu, Liu, Wright, & Filatotchev, 2014; Xia, Ma, Lu, & Yiu, 2014). In particular, a number of studies have focused on cross-border mergers and acquisitions (M&As) involving Chinese firms (Li, Li, & Wang, 2016; Li & Xie, 2013; Xie & Li, 2016; Zhang, Zhou, & Ebbers, 2011). Following Child and Marinova's (2014) suggestion that both the home and host country institutional contexts play important roles in determining M&A activity, Buckley and his colleagues have examined how China's 'Go Global' policy influences the location choices in Chinese acquisitions and also how host country political risks affect such activities (Buckley et al., 2016). They looked into national political and legal conditions (see also Meyer, Estrin, Bhaumik, & Peng, 2009), and also examined a large dataset on China's cross-border M&As. Much of the previous work in this area has focused on greenfield investments (Duanmu, 2012; Kang & Jiang, 2012), so the work of Buckley et al. (2016) has broken new ground.

However, to create repeatable cumulative knowledge in management and organization studies (Bettis, Ethiraj, Gambardella, Helfat, & Mitchell, 2016), it is important that future endeavors replicate and extend the perspective proposed by Buckley and his colleagues. Below, we point out several potential directions. First, to better explain how home and host country factors exert their influence, the economic, institutional and cultural contexts need to be explored in more detail. In particular, scholars should pay attention to the influence of 'contextual distance' referring to '. . . differences in the culture, institutional environments, and levels of economic development in the economies' (Li, Tian, & Wan, 2015: 289) on the M&A activities of Chinese firms.

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Second, in focusing on country-level analysis, inter-firm variance has been neglected. Each firm has different motivations for investing abroad (Dunning, 1993). And institutional influences may affect firms in different ways. For example, the effects of the 'Go Global' policy may depend on whether a firm is state-owned. State-owned firms may be more obligated to comply with government policy than private ones. Relatedly, if we can replicate Buckley et al. (2016)'s study at the firm level, we will be able to compare the effect size at the country level with that at the firm level. Unfortunately, Buckley et al. (2016) does not report the effect size in its results. This needs to be improved as a new trend is emerging that requires scholarly work to report the empirical results rigorously. For example, *Strategic Management Journal*, a leading journal in strategy, has explicitly stated in its submission guidelines that:

> *SMJ* no longer accepts papers for publication that report or refer to cutoff levels of statistical significance (p-values). In statistical studies, authors should report either standard errors or exact p-values (without asterisks) or both, and should interpret these values appropriately in the text. Rather than referring to specific cutoff points, the discussion could report confidence intervals, explain the standard errors and/or the probability of observing the results in the particular sample, and assess the implications for the research questions or hypotheses tested.

Leading management journals, including *Management and Organization Review* (MOR), also require authors to explicitly discuss and interpret effect sizes of relevant estimated coefficients. Therefore, future research should pay more attention to p value, confidence interval, and effect size of the regression coefficients.

Finally, most of the research on China's OFDI has focused on its determinants (Lu et al., 2014; Xia et al., 2014), but few have examined its consequences (Li et al., 2016). For example, in the CBA context, how do a deal's characteristics influence post-transaction performance? Will the integration be successful? How will the market react to the acquisition?

To address such questions and explore promising areas for future research, we extend Li and his colleagues' (Li et al., 2015) theoretical model on how contextual distance between parent firms influences international alliance learning and performance outcomes to the context of cross-border M&As. We first propose how contextual distance affects Chinese firms' post CBA performance. Then we explain how contextual distance affects a firm's cross-border M&A location choice and investment amount.

A CONTEXTUAL DISTANCE PERSPECTIVE ON CROSS-BORDER MERGERS AND ACQUISITIONS

Three dimensions of contextual distance including cultural, institutional and economic distance between the home and the host country are emphasized

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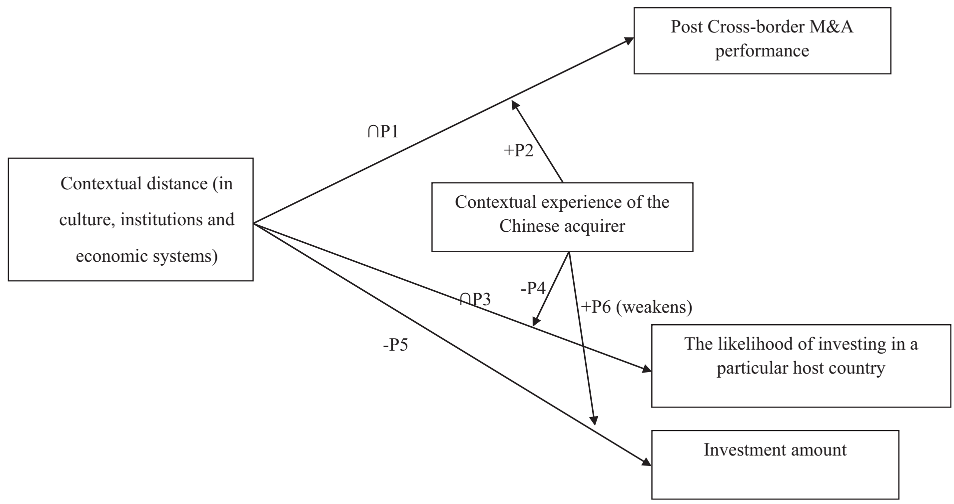

Figure 1. Contextual distance and Chinese MNEs' cross-border M&A

in Li and his colleagues' (2015) theoretical model. Cultural distance refers to differences between two countries in assumptions, values, mindsets, and norms of behavior of individuals (Hofstede, 1984; Kogut & Singh, 1988). Institutional distance describes the dissimilarity in regulative, normative, and social-cognitive systems (Eden & Miller, 2004). Economic distance refers to differences in the level of economic development, including different factor costs, infrastructure and technology (Ghemawat, 2001; Tsang & Yip, 2007).

Li et al. (2015) emphasizes how contextual distance affects the performance of international strategic alliances through learning processes between the two partners. Contextual distance, for example, can bring knowledge diversity (different views, mindsets and business models), but it can also impede communication and knowledge exchange, so it which can have an inverted-U shaped relationship with knowledge creation. But contextual distance may impede communication and knowledge exchange, thus dampening knowledge creation. In addition, contextual experience is '. . . the extent to which an [alliance] partner has been exposed to the host country contexts' (Li et al., 2015: 295). It will moderate the learning processes and thus the inverted-U shaped relationship between contextual distance and alliance performance according to Li and his colleagues. Although this framework was proposed in the context of international strategic alliances, it can be extended to Chinese firms' cross-border M&A investments. That would delineate from a learning perspective how contextual distance affects post-transaction performance, and also location choices and amounts invested. Figure 1 summarizes the proposed relationships.

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Contextual Distance and Post-acquisition Performance

Contextual distance may act a double-edged sword in determining performance after a merger or acquisition (Reus & Lamont, 2009). On the one hand, it can bring access to diverse knowledge and thus facilitate learning and knowledge creation, which can lead to better post-transaction performance for the acquirer. Cultural distance represents, among many other things, differences in managers' cognition, values and norms (Hofstede, 1984, 2001; Kogut & Singh, 1988). Such differences can of course tend to generate task conflict (Hambrick, Li, Xin, & Tsui, 2001; Shin et al., 2012). Institutional distance requires the acquiring firm to deal with different regulations and their interpretations, and again with different norms (Eden & Miller, 2004). This too increases the acquiring firm's exposure to different knowledge. Economic distance influences factor costs, infrastructure support and applicable technology (Ghemawat, 2001; Tsang & Yip, 2007). Greater distance can thus create learning opportunities (Cohen & Levinthal, 1990; Morosini, Shane, & Singh, 1998).

On the other hand, when the contextual distance is very great it tends to impede the integration process and thus dampen the M&A performance (Datta & Puia, 1995). Because different cultural norms create barriers to communication, they can make it difficult for merging firms to exchange knowledge about operations and other know-how (Fang & Zou, 2010; Lin & Germain, 1998; Luo & Park, 2004). In addition, firms from two countries with a very large institutional distance between them often have different organizational practices, routines and operating norms (Christensen & Rayno, 2003; Garud & Ahlstrom, 1997). It is difficult for one party to accept those of the other, thereby leading to conflict and misunderstandings (Kostova & Zaheer, 1999). And economic distance can also stimulate conflict between merging firms. For example, in early days of the economic reform, firms from China usually rely on poor technology, have relatively weak managerial skills and lack other expertise (Tsang & Yip, 2007). In an economy where such factors are much better-developed, the differences may lead to different opinions about issues such as employee compensation, which certainly might create conflict (Li et al., 2015). As a result, when the contextual distance is large, the firm resulting from a merger or acquisition might perform poorly because of miscommunication, inhibited knowledge exchange and conflicts in the integration process.

Proposition 1 (P1): Contextual distance (cultural, institutional or economic) between China and the home country of a target firm will have an inverted U-shaped relationship with post-M&A performance.

Chinese firms may have already invested in a host country before (Lu et al., 2014) or a potential Chinese acquirer may be located in a region of China where many foreign firms from a particular host country have invested. In either case, the experience acquired tends to build up the absorptive capacity of the Chinese firm, which should help it overcome the difficulties generated by contextual distance

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(Cohen & Levinthal, 1990; Cyert & March, 1963; Inkpen, 1998). Thus contextual experience should strengthen the positive aspects of the relationship between contextual distance and post-M&A performance because it is easier for a Chinese firm with a knowledge base to deal with different perspectives. At the same time, prior experience can build up trust between two parties (Gulati, 1995; Larson, 1992; Parkhe, 1993), reducing the possibility of their getting into major conflicts. So contextual experience should also weaken the negative aspects of the relationship between contextual distance and M&A performance.

Proposition 2 (P2): Contextual experience will moderate the inverted–U shaped relationship between contextual distance and post-M&A performance (P1), such that more contextual experience will enhance the positive influence of contextual distance when the distance is low or moderate while weakening its negative influence when the contextual distance is great.

Contextual Distance and Location Choice

When a firm chooses a location for cross-border investment, the contextual distance between that location and the home country can have an inverted-U shaped relationship with the probability of investing there. Contextual distance can bring new knowledge, viewpoints and mindsets to the acquiring firm, as has been discussed. When Chinese firms invest abroad, it is often to seek strategic assets (Buckley et al., 2016; Luo & Tung, 2007). Contextual distance helps to fulfill that goal by increasing the possibility of discovering new and complementary resources and knowledge. So greater contextual distance is likely to motivate Chinese firms to invest. On the other hand, great contextual distance entails substantial barriers to knowledge exchange between the partners. Anticipating this, firms are less willing to go to such countries if successful learning is less likely.

Proposition 3 (P3): Contextual distance (cultural, institutional or economic) between China and the country of a target firm will have an inverted–U shaped relationship with the Chinese firm's probability of investing in that host country.

That inverted U-shaped relationship will weaken with contextual experience. On the one hand, as experience increases the familiarity of a host country, a Chinese firm may perceive little possibility of acquiring new knowledge from the target, decreasing the motivation to invest. On the other hand, familiarity should improve communication (Zeira & Shenkar, 1990), reducing the impeding effects of contextual distance.

Proposition 4 (P4): Contextual experience will weaken the inverted–U shaped relationship between contextual distance and the probability of locating in a host country (P3), such that greater experience will weaken the positive influence of contextual distance on the probability when the contextual distance is small or moderate, while weakening the negative influence of contextual distance when the distance is great.

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Contextual Distance and Investment Size

After selecting a target, firms must decide what share to pursue and the amount of investment (Buckley et al., 2016). Greater contextual distance might be expected to reduce the firm's investment amount. From a learning perspective, if contextual distance increases the risk of unsuccessful knowledge exchange and knowledge creation (Li et al., 2015), firms anticipating that risk should tend to limit the amount they invest when the contextual distance is large.

Proposition 5 (P5): Contextual distance (cultural, institutional or economic) between China and the country of a target firm will have a negative relationship with the amount of investment by the Chinese firm.

Contextual experience will weaken the negative relationship between contextual distance and the investment amount because with greater familiarity the Chinese firm may perceive less risk of failing to acquire new knowledge from the target. It will therefore be willing to invest more in a country despite great contextual distance.

Proposition 6 (P6): Contextual experience will weaken the negative relationship between contextual distance and the size of investment sought by a Chinese firm in its overseas investments (P5).

CONCLUSION

This discussion has been a comment on Buckley et al. (2016)'s conclusions about how home and host country institutions influence the cross-border M&As of Chinese firms. Buckley and his colleagues examined the influence of home country political policies and host country political risks on Chinese firms' location choices and investments. Their findings contribute substantially to our understanding, but there is still room for replicating, validating and extending their work. First, future research could replicate and extend their work by examining a broader range of factors constituting the economic, institutional and cultural contexts and the differences between the home and host countries along these dimensions. They also did not consider inter-firm differences. Each firm has unique characteristics and thus different motivations to go abroad (Dunning, 1993). Third, while the antecedents of Chinese firms' foreign direct investments have been extensively examined (Lu et al., 2014; Xia et al., 2014), their consequences have received less attention (Li et al., 2016). Last but not least, future research should also pay more attention to rigorous reporting of the empirical results. For example, in the results section, scholars should explicitly report and discuss effect sizes of coefficients (Bettis et al, 2016).

The theoretical model developed in this discussion is designed to address these limitations. By doing so it extends the work of Buckley and his co-workers to a broader range of contextual factors which can influence Chinese firms' CBAs. In

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addition, while Buckley's work focused on the characteristics of home and host country separately, this discussion has attended to the dyadic differences in culture, institutions and economic systems between the two countries. This discussion has also considered subsequent performance of Chinese firms' CBAs, which has been underexplored in previous scholarly work (Li et al., 2016). It has extended the learning model developed by Li and colleagues (Li et al., 2015) to the context of Chinese firms' CBAs, generating several novel propositions.

More empirical endeavors are encouraged to test the model proposed in Figure 1. While several paths of the model have already tested in published studies, others have not been examined empirically. Future studies might also try to ask other interesting research questions such as how knowledge spillover from CBAs affects competition among local firms, and among local and global firms in China.

NOTES

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