Getting by with a Little Help from My Friends: Does Political Affinity Lead to Lower Acquisition Premiums?

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Key words: cross-border mergers and acquisitions, acquisition premium, government, international relations, foreign policy.

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ABSTRACT

While there is regular anecdotal evidence of political involvement in international business deals we still know very little on the importance of political affinity, or national preference alignment, on the cross-border acquisition process and particularly the initial acquisition premium. We argue that political affinity, as revealed by UN voting patterns, produces a positive environment for cross-border deals. It facilitates access to political and business elites and renders commercial diplomacy efforts more effective. Using a dataset of 925 cross-border deals (1990-2008) we find that political affinity between acquirer and target countries leads to lower bid premiums. Moreover, we show that this effect is moderated by the size of the firms involved and the level of political constraints faced by the government in the host country.

INTRODUCTION

'What would you think if I sang out of tune, Would you stand up and walk out on me ...
I get by with a little help from my friends', (Lennon and McCartney, 1967)

Wikileak cables have recently revealed to the public how US diplomats shill (and perhaps sing) for American companies and their economic interests abroad (Lipton, Clark, and Lehren, 2011). Political intervention in foreign markets is, however, a widespread behavior across countries as these same US cables indicate that diplomats regularly speculated on the special relationship between the former Prime Ministers of Italy and Germany, Berlusconi and Schröder, with Russia's president Vladimir Putin on business issues or on the growing and politically supported outreach of Chinese firms into Africa. These cables have also reminded us that politicians and diplomats could strongly weigh in during business deals. Diplomats regularly intervene in business transactions and set the business climate for their home market firms.

In such a context, we investigate the role of bilateral country relations in major cross-border merger and acquisition (M&A) deals and how foreign buyers can benefit by just a little help from a friend in the international political arena during the acquisition process. Large cross-border M&As are events of strategic importance for firms. They are also likely to mobilize the attention, effort and resources of governments (Clougherty, 2003; Saner, Yiu and Sondergaard, 2000). In cross-border deals foreign firms open themselves up to the political and regulatory pressures of the host countries. They must deal not only with the economic or cultural environment, but also the political context (Boddewyn and Brewer, 1994) as illustrated by numerous anecdotes.[1]

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[1] For instance, the rumors about the acquisition of the French dairy producer Danone by the American company PepsiCo brought an outcry among French politicians in 2005. A few weeks later the French government officially proposed to protect ten 'strategic' industries from foreign acquisitions. Similar interventions regularly occur in numerous countries including Canada, China, Italy, and the US (Bertrand *et al*., 2012).

We focus on the relevance of political relations between the countries where the acquirer and target firms are located for the bid premium offered by the acquirer in international M&A deals. The initial bid premium, albeit largely overlooked by the literature in management, is one of the major strategic decisions that an acquirer takes during the acquisition process. It has strong implications for M&A success (Haleblian *et al.*, 2009; Jemison and Sitkin, 1986). As Haunschild (1994: 393) states, '[a]cquisition premiums are an interesting and important area […] because there is so much variation in premiums, and large premiums can be disastrous.' In addition, the initial bid premium is an effective proxy for the confidence of managers in their ability to win the bid (Haleblian *et al.*, 2009) and their anticipated position on the bargaining table with the target firm. While the role of the host country institutional environment for the bid premium has more recently started to be examined (Bris and Cabolis, 2008; Rossi and Volpin, 2004), the nature of the dyadic political relationship between the host and home country and the role of governments as a key stakeholder therein has been neglected.

We still know very little about the role that foreign policy and bilateral country relations play in the strategy of firms and, especially, in cross-border acquisitions and the pre-acquisition process. Previous studies, in particular in political science or in economics, have explored the relevance of military conflict or political agreements between countries, such as military alliances or international trade and investment agreements, for international business patterns (Li and Sacko, 2002; Buthe and Milner, 2008; Egger and Merlo, 2007). There is, however, only very limited coverage both in terms of conceptual and empirical analysis in the management literature (Li and Vashchilko, 2010; Rangan and Sengul, 2009; Ramamurti, 2001; Nebus and Rufin, 2010) and existing works are mostly done at the macroeconomic level. There is a lack of understanding why, when, and how international relations can influence firm-level strategic decisions. Also, in

their impact on cross-border deals, multilateral international organizations or bilateral international agreements have been viewed mainly as platforms to increase country interactions, norm diffusion, and trust (Rangan and Sengul, 2009) or as mechanisms to generate credible commitments towards foreigners (e.g., Hafner-Burton, von Stein, and Gartzke, 2008). The foreign policy attitude of countries related to one another has been insufficiently considered. To investigate it, we focus on a higher order process through which the willingness of countries to pursue a cooperative or conflictual relationship with a partner country not only explains its actions in the political, but also international business arena. We link this willingness to the similarity of national preferences in global affairs, hereafter called political affinity (Gartzke, 1998), and argue that the extent to which national preferences are similar determines the readiness of national governments to interfere positively or negatively in cross-border acquisition negotiations.

Anecdotal evidence indeed seems to indicate that the nature of the bilateral country relationship affects the price paid in M&A deals. Acquirers have to offer higher premiums when potential friction between countries exists. For instance, in 2005, China's CNOOC bid for the US based UNOCAL was 9 percent higher than the rival Chevron's bid premium (Wan and Wong, 2009). In 2009, in China, Coca-Cola had to pay for a 200 percent premium for the juice producer Hiuyuan, even with the backing of Hiuyuan's principle shareholders, as the Chinese government blocked this investment (Bansal, 2011).

In the host market, foreign acquiring firms are likely to face potential discrimination based on their 'foreignness'. They, usually, suffer from information asymmetries and are poorly embedded in the target's stakeholder environment. But governments as key stakeholders in the acquisition process can reduce this discrimination. A government can help acquiring firms

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overcome information asymmetry via its direct and indirect business connections. It can also exploit the resource dependence of the target firm to influence the target's response to the offer. However, we argue that intervention by the host government in the bargaining process between the foreign acquirer and the host target firm is influenced by the type of relationship that exists between the host and home government. While negative political affinity goes along with 'unfriendly' relations and makes transactions for foreign firms more difficult and expensive, positive political affinity provides a door for economic cooperation between countries. We predict that this facilitates deal-making and increases the acquirer's bargaining power, leading to a lower acquisition premium.

We empirically test the relationship between political affinity and the acquisition premium on a sample of 925 cross-border acquisitions from 1990-2008. This sample is by construction limited to listed target firms and, therefore, large target, but also acquiring firms. We measure political affinity 'based on the similarity of nations' roll-call voting in the United Nations General Assembly' (Gartzke, 1998: 12). We find strong and robust evidence that the initial premium in cross-border deals is negatively related to political affinity. Moreover, the size of the acquiring and target firms moderates this effect. A larger size affects both the ability of firms to successfully gain clout among governments and their importance on the political agenda of governments. Also, the effect of political affinity is found to be reduced when the level of domestic political constraints that governments face in implementing their foreign policy objectives is higher.

THEORY AND HYPOTHESIS

Acquisition process and the M&A premium

The different strategic decisions that are taken by the acquirer during the acquisition process have ramifications for (the immediate) M&A success and, eventually, firm strategy and performance (Jemison and Sitkin, 1986). The acquisition process involves multiple steps that range from the initial negotiation and bidding stage to deal completion and later on the integration of the target firm (e.g., Dikova *et al.*, 2010; Muehlfeld, Rao Sahib, and Van Witteloostuijn, 2012). The pre-acquisition process, that includes all steps prior to deal closure, is the focus of our paper. It can 'be viewed as a process of negotiation' (Walsh, 1989: 307) between the seller and bidding parties. Following Walsh (1989) we understand negotiations as the 'process whereby two or more parties [attempt] to settle what each shall give and take, or perform and receive, in a transaction between them' (Rubin and Brown, 1975: 2).

During acquisition talks the initial bid (or acquisition) premium, which is defined as the difference between the price proposed for a target firm and the pre-acquisition market value, is an important determinant of the negotiation outcome and the potential for deal value creation. It provides in-depth insights into an acquirer's overall acquisition strategy. Since initiating a bid offers first-mover advantages (like preempting competition), determining the initial bid premium is one of the most significant strategic decisions an acquirer has to take in the acquisition process (Aktas *et al.*, 2011; Officer, 2003). Besides, the initial offer expresses the bidder's perceived strategic position in the negotiation and reveals the confidence of managers in their ability to win the bid (Haleblian *et al.*, 2009; Hayward and Hambrick, 1997). A lower initial bid premium indicates that the acquirer anticipates having advantages over the target firm in the bargaining process, while a higher bid premium reflects the opposite. The final bid premium, which is the outcome of the bargaining process started by the initial offer, then determines how the deal value is finally shared between the acquiring and target firms. Thus, the initial bid premium captures a

firm-level strategic decision that incorporates a company's view on its relative bargaining power, while the final bid premium incorporates also the outcome of the bargaining.

During the M&A price negotiations the interest of the acquiring firm is to pay as little as possible for the target firm in order to minimize the overall cost of the acquisition (Allen 1990; Reichheld and Henske, 1991; Haunschild, 1994; Haunschild and Beckman, 2002). Paying too much has been very often suggested as one major reason for the widely observed underperformance of M&As (Agrawal and Jaffe, 2000; Sirower, 1994; Haunschild, 1994; Hayward and Hambrick, 1997): Overpayment increases the uncertainty about the M&A success and may, eventually, jeopardize the performance of the acquirer by diverting too many financial resources from other necessary investments or obliging the acquiring firm to take cost-reduction decisions harmful in the long run (Krishnan, Hitt, and Park, 2007). A counter argument could also be made that firms pay more due to target undervaluation or higher expected synergies related with the deal. Evidence in this regard is, however, much weaker (Haunschild, 1994; Hayward and Hambrick, 1997; Slusky and Caves, 1991). Not surprisingly, the premium has been frequently used to proxy for overpayment (Haunschild, 1994; Hope, Wayne and Vyas, 2011; Kim, Haleblian and Finkelstein, 2011). Hence, we expect that, *ceteris paribus*, the acquiring firm would deploy all of its resources at its disposal and make all necessary efforts to pay the lowest possible M&A premium and incorporate these considerations in its initial offer.

The initial bid premium offered by the acquirer is therefore a direct function of the anticipated bargaining power of acquiring and target firms (Aktas, de Bodt, and Roll, 2010; Schwert, 2000). In this bargaining process, the target firm has intrinsic advantages: Due to asymmetric information it is better informed than the acquirer on its true value (Capron and Shen, 2007; Laamanen, 2007). Nevertheless, acquirers are not equally disadvantaged in their

access to information. Furthermore, independently of information asymmetry, the power of acquirers and their ability to influence decisions made by the target firm varies, affecting the acquisition premium paid.

The informational advantages held by the target firm can be partly compensated during the due diligence process. At this stage, acquiring firms can gain better knowledge about the target firm and reduce the uncertainty about its true value (Puranam, Powell, and Singh, 2006). But acquirers differ in the resources and capabilities which they can rely on to decrease information asymmetries (Lovallo *et al.*, 2007). Here, firms can leverage their external environment to gain access to information they do not have (Barney, 1991). There is, for instance, strong empirical evidence that board connections between firms matter in the flow of information. Board interlocks (and business networks in general) provide information conduits for the acquirer firms, leading to lower information costs and superior knowledge about the target firm, and thereby lower acquisition premiums (e.g., Haunschild, 1994; Haunschild and Beckman, 1998; Hambrick, 2007).

In addition, acquirers can have differential influence on target management (or shareholders) and its selling and price decisions. 'Organizations are not autonomous, but rather are constrained by a network of interdependencies with other organizations' (Hillman, Withers, and Collins, 2009: 1404). In this regard, the control over vital resources, that goes beyond informational resources, increases the power of the firm (Pfeffer and Salancik, 2003). With increasing dependency of the target firm on the resources held by the acquirer, the power the acquirer has over the target firm increases, making the target firm more likely to be influenced by the acquirer to meet its demands, in our case during the acquisition negotiation (Nienhüser,

2008). When, for instance, the target is a supplier to the acquirer, the latter can exercise its power as a major customer, influencing deal terms in its favor.

The acquiring and target firms are, however, often not the only parties that determine negotiation outcomes. By being able to offer resource access and dependency relationships to the firms involved, governments can also be key stakeholders in the process of negotiations and modify deal terms.

Government involvement in the acquisition process

In this paper we assert that acquirers can leverage the government to increase their bargaining power during negotiations (Saner *et al*., 2000; Uhlenbruck and De Castro, 2000). Government decisions not only form institutional restraints (DiMaggio and Powell, 1983). They can also offer opportunities to exploit in the M&A dance (Oliver and Hunzinger, 2008). During the acquisition process, the role of the government as a stakeholder has several possible facets: The government is involved in the course of the deal as a regulator (Clougherty, 2005). The state can also own the target firm (Johnson and Mitton, 2003; Shleifer and Vishny, 1994), be its customer (Agrawal and Knoeber, 2001), or its supplier in the case of a state-owned firm (Dinc, 2005). Overall, government executives are usually part of vast networks that include political and business elites (Kadushin, 1995; Colignon and Usui, 2001), into which they can tap to influence outcomes of business transactions. In summation, they are likely to be embedded with the target firm's network of stakeholders (Frooman, 1999; Rowley, 1997).

Through these different political and business connections a government can help an acquirer to solve its information asymmetry problem. A government can function as an intermediary that allows an acquirer to get a more accurate or speedier valuation of the target or

a better understanding of the reactions of domestic competitors to the deal announcement. It can even help an acquirer to be introduced to the target, before the target considers other alternatives. This can happen through a variety of ways: For instance, platforms where politicians meet business representatives can be used to connect acquirers to targets or intermediaries operating in the market for corporate control, such as investment banks or consultancies. Politicians and businessmen regularly interact in elite circles (e.g., the Rotary or Lion Clubs), in domestic and international business associations, in economic-political forums (e.g., the World Economic Forum in Davos, Switzerland), or during other special events that bring together government and business leaders.[2] In general, most governments and top politicians are well-connected to investment banks.[3] These relationships are not only established or maintained in the ordinary meetings of politicians with businessmen; they can sometimes also be nurtured by common party membership.[4] In addition, governments can organize visits for business delegations that make it possible for their home firms to establish contacts abroad, facilitating the search of business partners.[5] Foreign Direct Investment (FDI) promotion agencies, trade missions, or trade shows provide the opportunity for governments to encourage foreign companies to invest in local firms (Wilkinson and Brouthers, 2000).

In addition, a government can exploit the resource dependence of the target firm in order to change the bargaining position of the target firm and its response to the offer. Through

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[2] As an illustration, shortly after his election, French President François Hollande met German top-executives to discuss economic issues during a dinner in Paris (Le Monde, 2012).

[3] As an example of economic-political network, Dibelius, top-banker in particular on M&A issues at Goldman Sachs Germany, had contacts with Angela Merkel long before she was nominated as a chancellor for Germany. For instance, Dibelius organized dinner meetings for Merkel with businessmen (Capital, 2006). An example of the connection between investment banks and the political elite in the US is the appointment of Goldman Sachs' then CEO Henry Paulson as US Treasury Secretary.

[4] For instance, in Germany, the former head of Morgan Stanley Germany, Dirk Notheis, was a member of the Christian Democratic Union – the party of the current chancellor Angela Merkel. Recently revealed e-mails point at his active use of party connections for business deal-making (WirtschaftsWoche, 2012).

[5] In the newspaper L'entreprise.com (2010), a French entrepreneur describes his participation in a government led business delegation and explains how the French government introduces him to top businesses in India.

persuasion[6] or, for instance, regulation[7] the government can exert direct pressure on target management (or shareholders) to accept the deal at preferable conditions. A government can also leverage its power as a major customer[8] or use its influence on the local community to reduce resistance to the transaction.[9] Moreover, a government often controls or influences banks and can thus affect the target firm's access to loans or other forms of finance (Claessens, Feijen, and Laeven, 2008); similarly, it can affect labor unions and employee-employer negotiation outcomes during the deal process (Whittaker and Hayakawa, 2007).[10] As a result, we argue that, by leveraging the government, the acquirer is able to increase its relative bargaining power in M&A negotiations and can therefore, *ceteris paribus,* pay a lower premium.

The role of governments in cross-border transactions

In international transactions acquirers are particularly exposed to uncertainties and institutional challenges (Dikova *et al.*, 2010). They, usually, face larger information asymmetries with the local target firm than domestic acquirers (Boeh, 2011), placing them at a greater disadvantage in the bargaining process. Also, foreign acquirers experience larger difficulties in putting pressure on target management (or shareholders) due to a weaker legitimacy abroad (Kostova and Zaheer, 1999; Zaheer, 1995), which translates itself into a poorer embeddedness in the target's stakeholder environment. Hence, in particular foreign acquirers are likely to lack informational

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[6] For instance, in the acquisition battle over Aventis in 2004, the Swiss firm Novartis lost out against the French firm Sanofi-Synthelabo despite a higher offer price; the French government put pressure on the target management to accept the deal (Gelman, 2007).

[7] For instance, the Spanish government enacted new rules and imposed more restrictions in the electricity and gas market to stop the German firm E.On to acquire the Spanish firm Endesa (Clifton and Diaz-Fuentes, 2010).

[8] After the end of the Cold War (1993) the US Department of Defense encouraged consolidation of the defense industry as the procurement of new weapons systems seemed ready to decline (Hensel, 2010).

[9] When Novartis started bidding for Aventis the French Prime Minister Jean-Pierre Raffarin publically announced that the target products were essential for the defense of the country against bio-terrorism, increasing public hostility towards the Swiss offer (Gelman, 2007).

[10] For instance,-when Zhejiang Geely Holding Group of China took over Sweden's Volvo the government played an important role in placating union concerns regarding a Chinese owner (Leung, 2010).

resources and dependency relationships that could enable them to lower the (initial) acquisition price. Empirical evidence indeed suggests that they, on average, offer a higher premium than domestic bidders (Rossi and Volpin, 2004).

Furthermore, in a cross-border deal the acquirer has to consider both the governments of the bidder and target country as key players in the external environment the deal is embedded in. Both governments can decrease or increase hurdles and the uncertainty surrounding the acquisition and thereby affect the acquisition premium. The host government may either inhibit or attract foreign firms (Hymer, 1976; Stopford and Strange, 1992). As a result the acquirer has to either try to cope with this resistance or take advantage of help. While host governments can make acquisitions more difficult or uncertain, they may also aid foreign firms to overcome their missing local embeddedness by either not protecting their domestic target firms or through direct or indirect support to foreign acquirers as previously explained. This can enable the foreign bidders to propose a relatively lower premium. The acquiring firm may also be aided by its home government when expanding abroad. The home government is indeed concerned by the success and economic prosperity of its domestic firms since these determine the ability of this government to achieve its national political and economic goals (Lenway and Murtha, 1994). Private and public interests are often intertwined (Mahoney, McGahan and Pitelis, 2009).

Such political intervention abroad has been illustrated numerous times in the media and, although much less frequently, in academic research. For instance, Baron (1995) depicts the U.S. government involvement in the entry of Toys 'R' Us in Japan, while Frynas, Mellahi and Pigman (2006) explain the role of German-Chinese interstate relations when Volkswagen came to China. Since such interventions are intended to be secret, the process through which they occur has been seldom depicted in detail. Nevertheless, Henisz and Zelner (2005) exemplify that the

intervention may be as simple as a phone call such as a phone call that a former regulatory official in Argentina received from George W. Bush (the son of then President-elect George H.W. Bush) about investments of Enron. It may also be more complex like in the cross-border acquisition by UK's Cable and Wireless (C&W) of Japan's International Digital Communications corporation. According to Saner *et al.* (2000: 82), the deal succeeded due to the firm 'coordinating its moves with the UK government, the U.K. Embassy in Japan and other equally supportive foreign country governments [...].' Examining the entry of Lockheed Martin into Russia in 1993, Frynas *et al.* (2006) highlight the importance of the good relationship between the Clinton and Yeltsin governments and how this entailed, for instance, the signature of a bilateral treaty removing technology transfer barriers. 'All of this was made possible by a favorable political business environment. U.S.-Russian public cooperation in the space sector gave a privileged position to U.S. companies in Russia's economy' (Frynas *et al.*, 2006: 335).

Academic research has also tried to formalize such firm and country relationships, in particular in the framework of the obsolescing bargaining theory (e.g., Eden, Lenway, and Schuler, 2005) or more recently of political corporate strategy (Frynas *et al.*, 2006). Negotiations are usually viewed as a two-tier model (Ramamurti, 2001; Nebus and Rufin, 2010) where discussion between home and host countries (Tier 1) can benefit the home country MNE (Tier 2). The importance of bilateral or multilateral agreements, as negotiated in Tier 1, for international business has mainly been linked to their role as platforms to increase interstate exchange, liberalization, and trust (e.g., Rangan and Sengul, 2009; Ramamurti, 2001) or as mechanisms to increase the credibility of government policies towards foreigners (e.g., Buthe and Milner, 2008; Hafner-Burton *et al.*, 2008). We, however, still know very little both theoretically and empirically about what drives such government decisions and the implication

this has on cross-border business transactions. International institutional arrangements do not fully reflect the nuances by which bilateral political relations are made up and which shape foreign policy outcomes (Boehmer, Gartzke, and Nordstrom, 2004). Membership varies little over time as countries very rarely withdraw from ratified agreements or leave international organizations once admitted (Gartzke, 1998). Multilateral organizations in themselves also include a variety of national preferences of constituent countries (Boehmer *et al.*, 2004). Similarly, bilateral agreements may imperfectly reveal the national preference alignment of countries as agreements may reflect competitive economic pressures to gain access to capital in the case of bilateral investment treaties (Elkins, Guzman and Simmons, 2006), regional security needs, or the effects of a third party (Werner, 1997).

Building on the International Relations literature, we focus on a higher order process through which the willingness of countries to pursue a certain relationship with a partner country explains their actions in the international arena. Specifically, we argue that the political affinity between the home countries of the acquirer and target explains their willingness to act and thus shapes the host environment that the acquirer is confronted with during a cross-border deal.

Political affinity and the acquisition premium

In a cross-border deal the outcome of the acquisition process can be affected by the relationship between the target and acquirer home countries. The character of this relationship results from the 'willingness' (Gartzke, 1998: 6) of governments to engage either in conflictual or cooperative actions in relation to each other. In the international arena countries may have different 'objectives in global relations' (Gartzke, 1998: 7) or 'national preferences' guiding their foreign policy. In case of positive and high political affinity 'global objectives coincide' (Gartzke,

1998:12); countries share 'world views' (Gartzke, 1998: 7). Thus, they are more likely to take cooperative actions and act as a friend. Similar interests make conflict less likely (Kastner, 2005; Kinsella and Russett, 2002; Mansfield and Pevehouse, 2000). These national preferences, or interests, are shaped by a variety of factors such as 'governing structures or political cultures' (Gartzke, 1998: 7). Also, 'national wealth, geography, culture, ethnic identity, and idiosyncratic political agendas are likely to have major impact' on national preferences (Gartzke, 1998: 12).

In the acquisition negotiations we argue that positive political affinity provides a door for economic cooperation where negative affinity (or disaffinity) makes transactions for firms from 'unfriendly' countries more difficult and expensive.[11] Political affinity can assist the foreign acquirer in its bargaining position and therefore affect the price proposed for the host target firm. The acquirer is more likely to be able to rely on host governments to reduce information asymmetries or poor dependency relationships. As previously outlined such government actions can take several facets and either occur by direct intervention of the host country government in favor of the foreign acquirer or by connecting the acquirer to its own vast network which can be embedded with the target firm's network of stakeholders. Moreover, political affinity can be at play through more effective commercial diplomacy.

In world affairs diplomacy is a major foreign policy instrument. Being defined '[a]s a process of communication, negotiation and information-sharing, diplomacy largely revolves around the activities of professional (public) political actors and representatives of the state working in foreign ministries, permanent residencies or in international organizations' (Lee and Hudson, 2004: 355). Among diplomatic activities, both economic and commercial diplomacy highlight the connections between public and private actors. While economic diplomacy deals

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[11] The concept of political affinity was first developed by Gartzke (1998) as a construct to analyze the role of preferences of countries in militarized international disputes.

with general economic policy issues and has been implicitly the focus in the political bargaining literature (Ramamurti, 2001), commercial diplomacy has been seldom considered. It refers to specific support to individual businesses including activities related to business facilitation, advisory, and representation (Kostecki and Naray, 2007; Ruël and Zuidema, 2012). Assistance in partner search and negotiation has been recognized as an essential element of commercial diplomacy (Ruël and Zuidema, 2012). Thus, by providing a firm with access to resources and capabilities it lacks (Wilkinson and Brouthers, 2000), diplomacy can be of central importance for a foreign acquirer in its acquisition strategy. Commercial diplomacy should be more effective between countries of high political affinity. Neumayer (2008) empirically finds that political affinity matters for the creation of diplomatic representations and argues that, in case of political affinity, diplomatic representations can operate more smoothly, increasing their benefits and reducing their costs. When relations are friendly, we expect that diplomats' phone calls are more likely to be returned, access to host country information and business networks could be wider, faster, and less costly.

To summarize, the international political environment in which the acquirer operates influences strategic firm-level decisions taken during the acquisition process in general and its bidding strategy in particular. *Ceteris paribus*, an acquirer seeks to pay as little as possible. Since the M&A premium is a direct function of its relative bargaining power towards the target, increasing the latter is of foremost relevance to the acquirer. Here, both host and home market governments can be important players to access. Political affinity between home and host country creates the environment where foreign firms are viewed more positively by the host country government than in conditions of discord. In such an environment, governments are more ready to help foreign firms through information access and the leverage of dependency

relationships; commercial diplomacy can become more effective. This increases the acquirer's bargaining power, leading to a lower acquisition premium. In contrast, bidders from home countries with lower political affinity to the host country face larger difficulties in obtaining such benefits and are therefore expected to offer a higher price. Hence we predict:

Hypothesis 1: The level of political affinity between acquirer and target countries is negatively related to the initial acquisition premium for cross-border M&As.

Moderating role of firm size

We expect that political affinity matters. It, however, is very likely that its role is not the same across firms and their attributes. Specifically, the interplay of firms with governments during the acquisition process and thereby the relevance of political affinity could depend on firm size. There exists ample evidence that firm size is an important antecedent of political corporate strategy (Hillman, Keim and Schuler, 2004). It affects a firm's ability to engage in politics and successfully gain clout among government officials (Oliver and Holzinger, 2008; Salamon and Siegfried, 1977). Firm size has also been found to significantly influence acquisition behavior and the bid premium. However, the exact channels through which it exerts impact have not yet been clearly identified (Haleblian *et al.*, 2009). In our context, we argue that a differential use of government relations could explain the variation in premium outcomes due to firm size.

First, larger firms have a greater stock of resources and capabilities (Bausch and Krist, 2007) that are needed for engaging in acquisitions and designing an optimal bidding strategy. These encompass deal-specific knowledge and expertise or ties to business partners and political decision-makers (Lin *et al.*, 2009). To access and sway the government, relational, but also financial, or organizational resources are necessary (Dahan, 2005). Second, larger firms can

recoup investments more easily than smaller ones. Larger firms can better bear the fixed costs of establishing an infrastructure to manage firm-government relations in general and in gaining support of politicians in M&A transactions in particular (Salamon and Siegfried, 1977).

Not only can bigger firms exert more impact on governments, but governments usually pay more attention to bigger firms. The decisions that may influence a cross-border acquisition result from a trade-off for the government between foreign policy and domestic interests (Putnam, 1988). In this regard, bigger firms tend to be more visible and legitimate (Baum and Oliver, 1991). They are usually placed higher on the political agenda: Their prosperity is often perceived as necessary for the future of the country. Also, help in favor of large firms could receive more popular support as the activity of large firms touches more customers, buyers, or workers and hence concerns more votes that politicians need to be reelected.

Thus, we argue that the size of acquirers and target firms can moderate the effect of political affinity on the bid premium. A larger target firm has more resources to be deployed in the political market. These resources can be used to counter a government's inclination to help foreign acquirers from politically close countries. Also, the loss of autonomy of a large target firm may raise more suspicion and concerns (e.g., in terms of employment) about the impact of the foreign acquisition on the host country economy (UNCTAD, 2000). This can lead to resistance or a refusal to help acquirers from politically friendly countries by host governments. Therefore, we expect that the negative effect of political affinity on the initial acquisition premium could be increasingly offset with the size of the target firm.

Hypothesis 2: The relationship between the initial acquisition premium and political affinity is moderated positively by the size of the domestic target firm.

The role of the size for foreign acquiring firms is less clear-cut. On the one hand, larger acquirers have a higher ability to access their home government and, through the latter, to benefit from political affinity gains. If there is affinity between the home (acquirer) and host (target) governments this political capacity may lead to lower bid premiums. But foreign firms have an alternative to gain political advantages abroad. With a larger set of resources, in particular political ones, they can negotiate with host governments directly. The larger the acquiring firm, the more resources can be dedicated to creating firm specific political capital in the host country and the higher is the ability to offset foreign liabilities. Hence, larger firms would depend less on the political relationship between its home country and the host country. Thus, the moderating role of the acquirer size in the relation between the initial bid premium and political affinity is ambiguous. We state:

> *Hypothesis 3a: The relationship between the initial acquisition premium and political*
> *affinity is moderated positively by the size of the foreign acquiring firm.*
> *Hypothesis 3b: The relationship between the initial acquisition premium and political*
> *affinity is moderated negatively by the size of the foreign acquiring firm.*

Moderating role of domestic political constraints on the host government

We have so far argued that the host government, that has the task of implementing foreign policy (Moe and Howell, 1999), could interfere in M&A negotiations in line with political affinity considerations and hence foreign policy objectives. While the host government desires to realize its foreign policy interests, it also has to take into account domestic institutional arrangements. Political decisions may require approval in ratification processes, consent by bureaucrats for their implementation, or support by businesses or public opinion in general (Putnam, 1988).

With a higher strength of institutional constraints, governments are more accountable in their actions (Besley and Case, 2003), putting any government interference under additional scrutiny. If political decision-making procedures limit governments in their ability to set policy outcomes, foreign policy objectives are more difficult to get implemented (Morgan and Campbell, 1991; Rogowski, 1999). For instance, this can concern decisions that require a formal approval of a legislative body, such as legal provisions necessitating legislative authorization for foreign ownership in certain industries, privatization of assets, or the granting of licenses.

In general, governments are less likely to publicly intercede in deal-making, even if no formal approval by third parties is needed, the more they depend on cooperation with others in the political decision-making process. 'For any choice of foreign policy, there will be winners and losers at the domestic level; what one player values, another may discount' (Bates, 1997: 10). If a government fears that its actions would engender a negative response from political partners or opponents and lessen its political capital to form consensus during future political negotiations, it is most likely to abstain from making decisions. Those involved in the political decision-making process, such as legislators, consider the impact the foreign policy actions have on their own constituencies and, accordingly, judge their readiness to support the government in its actions (Krasner, 1978; Milner and Tingley, 2011). In the long-run, politicians need to maintain a level of popularity and political support to insure future reelection (Downs, 1957).

In democracies multiple avenues exist through which individuals can express their opinions and hold politicians accountable for their actions (Dahl, 1998; Connolly, 2005). Democracies typically guarantee free and fair elections of the executive and legislative, and give citizens the right to vote and compete for political offices. Also, they are, usually, associated with freedom of association and expression or an independent judiciary (Dahl, 1998). This

reduces the likelihood that the government will take any particular discriminatory decision in favor or against foreign acquirers (Li and Resnick, 2003). In contrast, in autocracies policy outcomes are mostly defined by the interests of the political leaders and the small elites surrounding the autocrat (Magaloni, 2008), which diminishes the importance of negative public or civil society reactions to decisions which favor or hurt foreign firms.

Hence, the variation in the institutional constraints governments face in exerting power in the domestic context determines their ability to push through foreign policy interests and then to aid or harm foreign firms in their acquisition endeavors – a decision that is influenced by the political affinity between the acquirer and target home countries. Therefore, we state:

> *Hypothesis 4: The relationship between the initial acquisition premium and political affinity is moderated positively by the level of domestic political constraints on the host government in the target country.*

METHODOLOGY

Data and sample

The sample is obtained from the Thomson ONE database. We select firms that have relevant premium and financial statement information, namely total assets, EBITDA and firm debt, available. The deals are either indicated as completed or withdrawn in the database. Furthermore, we exclude, for instance, divestitures of assets, leveraged buy outs, and joint ventures. We only keep deals where the acquirer purchased more than 50 percent of the equity of the entire target firm and hence gained majority control. The sample is further limited due to the availability of our explanatory variables. The final sample consists of 925 cross-border deals from 31 (32)

acquirer (target) nations for the period 1990-2008 with an average four-week bid premium of 43 percent.

Empirical model

The bid premium can be modeled as follows: $P_{ijt} = f\left(C_{ijt}, X_{ijt}, D_{ijt}, I_j, T_t\right)$ where P_{ijt} is the initial bid premium at which firm i announces to take over firm j at time t. The vector C_{ijt} represents the country-level variables that are related to acquirer i and target j. X_{it} and X_{jt} are vectors of firm-level attributes of acquirer i and target j, while D_{ijt} are characteristics particular to the focal deal. We add a vector of year dummies T_t and industry dummies I_{jt} to account respectively for time specific effects and unobserved industry heterogeneity. Note that all our monetary data are expressed in US dollars and are deflated using the GDP deflator (Source: World Bank). In all regressions we apply pooled least squares regressions like in previous research (e.g., Haunschild, 1994; Hope *et al.*, 2011; Laamanen, 2007). To take into account heteroskedasticity, we report robust standard errors (i.e., Huber-White-Sandwich estimator of variance).

Dependent variable

The dependent variable P_{ijt} is the value of the initial premium of the offer price to the target closing stock price four weeks prior to the original announcement date as reported by Thomson One. Based on the analysis of SDC premiums by Officer (2003) and following Hope *et al.* (2011) we trim the premium data to eliminate outliers by dropping the largest and smallest 2 percent of initial bids.[12]

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[12] We also estimated our models with a natural logarithm transformed premium measure. The results hold.

Independent variables

The vector of country-level characteristics C_{ijt} includes our focal variable, the political affinity of countries, which we measure using the voting patterns in the UN General Assembly (Source: Gartze, 1998).[13] Previous research in political science has demonstrated the value of utilizing United Nations (UN) voting patterns as a means to account for national preferences and thereby political affinity between countries (e.g., Gartzke, 1998; Stone, 2004). In the UN General Assembly, the public stance on a large number of issues is revealed and countries are relatively free to express 'sincere' preferences since the cost that they incur for showing them in the general assembly are small (Gartzke, 1998).[14] Those countries that vote together are expected to be friends and those with 'negative affinity scores are, ceteris paribus, more likely to be considered as 'enemies' […]' (Gartzke, 1998:15). UN General Assembly voting gives a fine-grained measure of bilateral country behavior that varies over time, thereby providing a dynamic perspective on world views. In practice, UN voting covers almost the total universe of countries and is available over a long period of time.

To examine hypotheses 2, 3a, and 3b, we measure the size of the firm with the natural log transformed value of total assets (Source: Thomson ONE). To capture the level of domestic political constraints on the host government (hypothesis 4), we rely on several variables. First, we employ two measures that capture institutional obstacles a government experiences in shaping political outcomes and pushing through foreign policy interests. We use the executive constraints measure from the Polity IV database. This variable focuses on the institutionalized

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[13] Political affinity is based on Spearman rank-order correlations of roll-call voting patterns in the UN General Assembly with values ranging between -1 and 1. Dyads which have the same voting pattern obtain the value 1, while those with a complete opposite voting pattern are assigned the value -1.

[14] For the case of African countries, for instance, Stone (2004) highlights that 'patrons are not concerned about how African countries vote in the UN General Assembly but, rather, that these votes are unimportant enough to serve as a sincere measure of countries' foreign policy preferences' (Stone, 2004: 580).

constraints on the decision-making powers of the government, either by the legislature, a party council, or any other accountability group. In this context we also test the relevance of government fractionalization (Source: Database of Political Institutions), which reflects the probability that two deputies which are selected at random among government parties are not of the same party. In coalition governments it is more difficult to find consensus within the government for a coherent action agenda (Martin and Vanberg, 2003). Second, we use political regime type, based on the degree to which a country is democratic or autocratic, to account for the constraints a government has to deal with due to political pluralism in general. Following the existing literature (e.g., Munck and Verkuilen, 2002) our central measure is the PolityIV score which value depends on the competitiveness of political participation, the regulation of participation, the openness and competitiveness of executive recruitment, and constraints on the chief executive.

Control variables

To control for country dyadic factors that possibly explain the premium effects, we include various measures that reflect the degree to which the country of acquirer i differs from the country of target j in terms of political system, culture, economic development, or shareholder protection.

First, we control for the difference in the political system and the cultural distance between countries. Political affinity could be co-determined or the result of political regime or cultural similarities. Nevertheless, there exists strong heterogeneity of national preferences even within similar regime types or cultures (Gartzke, 1998; Gartzke and Gleditsch, 2006). We, again,

use the PolityIV score to capture the political regime. For cultural distance we use the well established measure based on Hofstede's (1980) data (see, e.g., Hope *et al.*, 2011).[15]

Besides, we take into account shareholder protection differences. Our time-invariant measure for shareholder protection is computed using the updated version of the anti-director rights index from La Porta *et al.* (2008), which we multiply with the rule of law, following the methodology of Wurgler (2000). Like Rossi and Volpin (2004) or Bris and Cabolis (2008) we also consider the GDP per capita differences to capture cross-country economic development disparities (Source: World Bank). It is calculated as the difference of the natural logarithm transformed values of acquirer i and target country j.

In our estimations we include several firm-specific control variables (X_{ijt}) that are likely to determine the level of the acquisition premium according to prior research. We, first, account for the difference of the size of target and acquiring firms (natural logarithm transformed value of their total assets). We, moreover, control for the profitability of the target and acquirer firm using the ratio of EBITDA over total assets. We also include their debt ratios (the ratio total liabilities over total assets) and the experience of the acquirer i in concluding deals (as computed by the number of completed acquisitions prior to the focal acquisition). To control for acquirer ownership specificities we add a dummy variable which takes the value one if the acquirer is 50 percent or more owned by the government and zero otherwise. As a robustness check we also include an indicator variable if the acquirer is a financial buyer.

For deal specific variables (D_{ijt}) we account for the percentage sought in the target firm and whether the deal was completed or not. Furthermore, we include indicator variables that measure if there are competing bids, the bid is a tender, or a cash deal. Finally, as a robustness

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[15] In general, we find that the correlation between political regime similarity (or cultural distance) and political affinity is low.

check, we account for the hostility of the deal and the industry relatedness between firms. Acquisitions are defined as horizontal when both business partners are within the same 2-digit SIC industry. We obtain all our firm- and deal-level variables from the Thomson ONE database.

RESULTS

Descriptive statistics and cross-correlations of the variables included in the base model are provided in Table 1. There is no sign for multicollinearity. In Table 2 we show the results of the regressions where we test our different hypotheses. As predicted in hypothesis 1, the variable Political Affinity is negative and significant ($p<0.01$) in all models. *Ceteris paribus*, the higher the level of political affinity, the lower the acquisition premium.

*** Insert Table 1 about here ***

*** Insert Table 2 about here ***

Concerning our control variables, we note that the difference in the political regime or cultural distance does not affect the acquisition premium. Shareholder protection differences are insignificant, too. However, the large disparity in economic development often significantly affects the acquisition premium.

In models 2 and 3 in Table 2 we examine, respectively, the moderating role of the target and acquiring firms. Our findings support hypotheses 2 and 3a. The effect of political affinity varies across firms that are involved in the deal. The reduction in the bid premium is lower with a greater size of the target firm and acquirer. Larger firms are able to use their power and resources to influence political decision making in the host market, irrespective of political relations between the home and host government.

Then, we study if domestic political constraints on the host government moderate the relationship between political affinity and the acquisition premium using the variables executive constraints (model 4), government fractionalization (model 5), and the democracy level (model 6). Overall, there is clear evidence that, when the host government is constrained, the effect of political affinity is lessened, which supports hypothesis 4.

To confirm the robustness of our findings we do several sensitivity checks, which we present in Appendix 1. We add a few more firm and deal-level control variables that could explain the M&A premium (model 1). The effect of political affinity remains robust. Then, we replace our dependent variable, the initial bid premium, by the final bid premium (model 2) and we lag political affinity by one year (model 3) to control for possible endogeneity issues. Results are again robust. Finally, we investigate possible selection problems. First, deals between country dyads with a low political affinity score might be deterred due to these bad relations. We follow Capron and Guillen (2009) and estimate the determinants of the number of acquisitions between two countries using a negative binomial regression model (results not shown, but available on request). This allows us to obtain the predicted number of acquisitions between country dyads. When including this predicted number of acquisitions as an additional regressor in our base regression model (model 4), the variable is, however, insignificant, and political affinity is still strongly affecting the bid premium. Second, when focusing on cross-border deals, we omit the domestic alternative a target has when agreeing on being bought by a foreigner. But, domestic and foreign acquirers could compete for the same target. Also, some firms could just be able to acquire local firms because their home country has no political friend abroad.[16] In model 5, we add purely domestic deals to our sample, to overcome this potential selection issue. Political affinity still matters strongly. In addition to adding domestic acquisitions, we follow

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[16] For domestic deals political affinity is set to the maximum value, 1.

Bris and Cabolis (2008). In model 6, we match cross-border deals with similar domestic ones based on target firm and industry characteristics. We then take the difference between the premiums paid in these two deals as the dependent variable. Including target firm and industry controls is not necessary anymore.[17] We find that the higher the political affinity, the lower is the initial acquisition premium in cross-border relative to domestic deals – confirming our previous results.

DISCUSSION AND CONCLUSION

In this paper we examine the role of political affinity between the acquirer and target firm countries for M&As and in particular the bidding strategy. We find that the initial bid premium decreases with a higher level of political affinity. The effect is moderated by the size of the firms involved in the deal and the level of government constraints in the target country. These findings point at the importance of the political climate in the international arena in cross-border deals.

This piece of research contributes to the management field in different ways. We, first, extend the literature on M&As by highlighting the role of governments as external stakeholders and international relations in the M&A process. Jemison and Sitkin (1986) stress the need for considering the acquisition process in more detail. But only a few studies have studied decision making during the acquisition process (see e.g., Muehlfeld *et al.*, 2012; Finkelstein and Haleblian, 2002) and in particular in cross-border deals (see e.g., Dikova *et al.* 2010). Although often overlooked, the premium offered by the acquirer is an important element of the acquisition process and strategy. Not surprisingly, an increasing number of works have more recently

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[17] Similar to Bris and Cabolis (2008) we match deals using the following criteria: More than 50 percent of the shares are acquired in the domestic deal; the deals are announced in the same year; the target firm belongs to the same industry (2-digit SIC code) and country; and the target firm in the domestic deal is the closest in terms of total assets to the target firm in the cross-border deal.

emerged on this topic (e.g., Beckman and Haunschild, 2002; Hope *et al.*, 2011; Kim *et al.,* 2011). In this paper, we outline the role governments can have during M&A negotiations and how they can influence firm actions by giving access to relevant information or resource power. We demonstrate that international relations play a role during the cross-border acquisition process and that the political relationship between countries can determine the behavior of governments towards foreign firms. (Dis)affinity makes (negative) positive discriminatory behavior, such as an access to political-business networks, more likely and commercial diplomacy efforts more (un)effective at the (detriment) benefit of the foreign acquirer. To some extent, this research is therefore related with the growing interest in firm networks for M&A deal outcomes (see e.g., Haunschild, 1994; Lin *et al.*, 2009).

Our results on the acquisition premium are also relevant for the international strategy field and the wider research community in International Business (IB). Building on a vast literature examining the role of the host country political environment in the strategic decisions of foreign firms (e.g., Boddewyn and Brewer, 1994; Henisz and Zelner, 2005), we find that this environment, and therefore the strategy a foreign firm can pursue, is likely to be shaped by the political relationship between the host and home countries. We stretch the boundaries of previous macro-level work that found that international relations are important for country-level aggregated FDI (Li and Vashchilko, 2010; Li and Sacko, 2002) to firm-level decisions in international deals. In this context we extend previous works on the impact of multilateral or bilateral international agreements on international business (e.g., Ramamurti, 2001; Rangan and Sengul, 2009) by referring to the concept of political affinity. Political affinity is a finer-grained and higher-level order concept that focuses on the willingness of governments to carry out cooperative or conflictual foreign policy actions. In this paper, we argue that political affinity

influences governments in their readiness to effectively interfere in international business transactions. In the same vein as Li and Vashchilko's comments (2010) when analyzing the relationship between aggregated FDI flows, security alliances, and militarized conflict, we call for more dialogue between the fields of international relations and international strategy or IB. MNEs are not without grounding in global markets as firms retain a home nationality (e.g., Pauly and Reich, 1997). The world market is spiky and political friction can contribute to these spikes.

Finally, following Oliver and Hunzinger (2008) we stress that an active strategy affecting the political environment not only helps to overcome restrictions imposed by politicians, but also to create business opportunities or take advantage of them at favorable conditions. We prolong this by explaining the importance of influencing both home and host country governments. Given a certain level of political affinity, we show that for different types of firms the relevance of influencing home and host country governments varies.

Hence, an important managerial implication from our results is that firms seeking to expand abroad via an acquisition should have a close examination of the political aspect of the deal during the due diligence process. The bidding procedure for assets should incorporate not only the political situation in the target country, but also the dyadic relationship between the home and host country. In this context, managers need to be cognizant that political connections established within its home country are of value not only at home but also abroad. By at least partially relying on connections with their home government, efforts to establish and maintain a political presence abroad can be bundled and more effectively utilized. Following Saner *et al.* (2000) we assert that business diplomacy that makes use of political connections at home and abroad is a core competency for MNEs. But we suggest that in developing diplomatic skills and practices firms should account for political affinity variation between countries and over time.

As in other studies there are several limitations to our paper. First, our sample consists by construction of listed targets and thereby of large target, but also acquiring firms. The sample selection of large deals with publicly listed firms certainly helps in reducing the possibility of a spurious relationship between political affinity and the bid premium since these target firms and acquirers are large and visible firms and deals are likely to be well advertized. Consequently, these M&A deals have a higher probability to attract the attention of governments. On the other hand, this sample selection limits generalizability as we do not include small or private transactions wherein information asymmetry, for instance, may be even greater, but involvement of the government lower. Furthermore, our sample includes nearly no state-owned firm as a buyer or target and, consequently, we are unable to explore this ownership dimension further. Second, we cannot empirically analyze the mediating effects of commercial diplomacy in the relationship between the acquisition premium and political affinity. Publicly available data on diplomatic representation (Bayer, 2006) only accounts for the presence of general diplomatic ties, but not commercial diplomacy. Also, they do not capture the intensity of diplomatic exchanges. Moreover, during the period we study, all host and home countries in our sample already have some diplomatic representation in the partner country. Finally, because of our multi-country setting, to measure the political resource of a firm, we need to rely on the size of the firm as a rough, but widely accepted proxy of political resources (Hillman *et al.*, 2004). Capturing political connections and their form is a very complex task (Fryas *et al*., 2006), especially when comparing them across a large number of countries. However, it would be interesting in a single country setting to analyze different types of political resources and how they are at play with political affinity. These different limitations offer avenues for future

research and new insights into the interplay between governments' actions and a firm's business

strategy in the international political and economic arena.

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Table 1: Summary Statistics and Correlations

VARIABLES	Mean	S.D.	-1	-2	-3	-4	-5	-6	-7	-8	-9	-10	-11	-12	-13	-14	-15	-16	-17
-1 Political Affinity	0.332	0.378	1																
-2 Difference in Political Systems between Countries	0.497	1.758	-0.0401	1															
-3 Cultural Distance	1.741	1.158	0.0987	0.373	1														
-4 Difference in Shareholder Protection between Countries	-0.108	1	-0.0707	0.0443	-0.0333	1													
-5 Difference in GDP per Capita between Countries	-0.106	0.725	0.1285	0.0578	-0.1012	0.1291	1												
-6 Difference in Size between Acquiror and Target	2.431	1.884	-0.0808	0.0138	-0.0315	-0.0482	0.0856	1											
-7 Acquiror ROA	0.113	0.109	-0.0725	0.0095	0.0021	-0.0093	-0.044	0.0878	1										
-8 Target ROA	0.024	0.075	0.043	-0.035	0.0065	0.0467	0.0012	-0.3465	0.231	1									
-9 Acquiror Debt Ratio	0.55	0.217	0.1021	-0.0477	0.0593	0.0244	0.0527	0.1441	-0.0727	0.014	1								
-10 Target Debt Ratio	0.513	0.277	0.116	0.0248	0.0206	0.0135	0.0213	-0.0543	-0.0428	0.0375	0.4032	1							
-11 Acquisition Experience	3.091	5.196	-0.0625	-0.0014	-0.0084	-0.0188	0.0827	0.3869	0.0253	-0.0758	0.1569	0.0034	1						
-12 State-Owned Acquiror	0.008	0.087	0.0834	0.0037	0.02	0.0366	0.0034	-0.0072	-0.008	-0.0128	0.0487	0.057	0.0033	1					
-13 Cash Payment	0.583	0.493	-0.1312	-0.03	0.0407	0.0148	-0.1364	0.2022	0.1541	-0.0108	0.0633	-0.0161	0.0722	-0.0526	1				
-14 Multiple Bidders	0.111	0.315	0.0406	-0.018	-0.0728	-0.1425	0.0064	-0.019	0.0626	0.0924	-0.0076	0.0036	0.0243	0.0881	0.0138	1			
-15 Tender Offer	0.59	0.492	0.2099	-0.0307	0.0804	-0.1373	0.0416	0.0462	0.0888	-0.0148	0.0645	0.042	-0.0439	-0.0033	0.2222	0.0503	1		
-16 Stake Sought	94.197	13.106	-0.186	-0.2357	-0.1961	-0.0837	-0.1707	-0.0914	0.0054	0.049	-0.0734	-0.0848	-0.0698	-0.0756	-0.0351	0.0502	0.0053	1	
-17 Completed Deal	0.923	0.266	-0.0858	0.0007	0.0171	0.0649	-0.0365	0.053	-0.0189	-0.0513	0.0216	0.0039	-0.0474	-0.0685	0.0278	-0.4014	0.0488	-0.0196	1

Table 2: Acquisition Premium and Political Affinity

VARIABLES	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
Political Affinity	-9.984***	-37.79***	-34.96**	-124.2***	-16.49***	-71.68***
	(3.512)	(10.73)	(14.24)	(45.75)	(4.477)	(24.61)
Difference in Political Systems between Countries	0.586	0.645	0.484	1.393*	0.753	1.257
	(0.720)	(0.709)	(0.717)	(0.754)	(0.732)	(0.788)
Cultural Distance	0.0304	0.424	0.496	-0.382	0.00900	-0.399
	(1.089)	(1.102)	(1.105)	(1.088)	(1.118)	(1.092)
Difference in Shareholder Protection between Countries	-0.0567	0.208	0.163	-0.131	-0.616	-0.114
	(1.276)	(1.272)	(1.271)	(1.276)	(1.301)	(1.268)
Difference in GDP per Capita between Countries	3.107*	3.256*	3.233*	2.555	3.978**	2.433
	(1.683)	(1.742)	(1.728)	(1.735)	(1.671)	(1.776)
Difference in Size between Acquiror and Target	2.116**	1.491	2.992***	2.125**	2.121**	2.115**
	(0.874)	(1.004)	(0.977)	(0.870)	(0.872)	(0.873)
Acquiror ROA	-1.011	2.610	2.187	-1.451	-1.201	-1.560
	(15.78)	(15.16)	(14.97)	(15.81)	(15.67)	(15.81)
Target ROA	21.41	28.02	27.76	20.01	22.95	20.13
	(26.92)	(27.61)	(27.11)	(26.89)	(26.52)	(26.92)
Acquiror Debt Ratio	-16.54**	-12.96	-13.33*	-17.46**	-16.28**	-17.39**
	(7.613)	(8.064)	(8.073)	(7.456)	(7.747)	(7.450)
Target Debt Ratio	1.806	3.819	2.898	1.818	1.702	1.765
	(5.614)	(5.540)	(5.659)	(5.599)	(5.662)	(5.603)
Acquisition Experience	-0.403*	-0.245	-0.224	-0.423*	-0.392*	-0.419*
	(0.228)	(0.230)	(0.238)	(0.230)	(0.228)	(0.230)
State-Owned Acquiror	1.126	1.045	2.109	-0.360	-1.702	-0.123
	(14.73)	(13.99)	(13.96)	(14.46)	(14.08)	(14.55)
Stake Sought	0.402***	0.391***	0.395***	0.366***	0.407***	0.382***
	(0.0849)	(0.0837)	(0.0852)	(0.0882)	(0.0842)	(0.0859)
Completed Deal	10.63**	10.97***	10.53**	10.14**	10.47**	10.03**
	(4.266)	(4.206)	(4.252)	(4.265)	(4.269)	(4.258)
Multiple Bidders	15.69***	16.84***	16.31***	15.26***	15.67***	15.23***
	(4.146)	(4.131)	(4.111)	(4.147)	(4.162)	(4.153)
Tender Offer	7.130***	6.326**	7.029***	6.706**	7.316***	6.866***
	(2.620)	(2.622)	(2.633)	(2.632)	(2.626)	(2.622)
Cash Payment	1.566	1.740	1.346	1.542	1.762	1.549
	(2.683)	(2.678)	(2.671)	(2.669)	(2.661)	(2.663)
Target Size		-3.209***				
		(1.105)				
Political Affinity * Target Size		4.711***				
		(1.605)				
Acquirer Size			-2.513**			
			(1.060)			
Political Affinity * Acquirer Size			3.031*			
			(1.600)			
Executive Constraints				-3.704		
				(4.810)		
Political Affinity * Executive Constraints				16.69**		
				(6.644)		
Government Fractionalization					-9.670	
					(8.530)	
Political Affinity * Government Fractionalization					30.93**	
					(12.51)	
Polity Score						-1.850
						(1.798)
Political Affinity * Polity Score						6.403**
						(2.519)
Constant	2.609	22.95	17.66	29.49	8.229	21.23
	(20.41)	(25.42)	(20.61)	(37.96)	(20.07)	(25.94)
Observations	925	925	925	924	924	925
R-squared	0.121	0.135	0.129	0.128	0.127	0.128

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1
Sector and year fixed effects are included in each regression.
OLS estimation with robust standard errors (i.e. Huber/White/sandwich estimator of variance) is applied.
Models 1 to 3 test hypotheses 1 to 3 respectively. Models 4 to 6 test the hypothesis 4.

Appendix 1: Robustness Check

VARIABLES	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
Political Affinity	-10.02***	-21.05***		-9.156**	-6.902***	-7.567**
	(3.509)	(7.708)		(3.697)	(2.187)	(3.657)
Political Affinity (Lagged one year)			-9.093**			
			(3.533)			
Difference in Political Systems between Countries	0.560	0.166	0.639	0.611	1.004	0.903
	(0.714)	(1.150)	(0.719)	(0.728)	(0.669)	(0.758)
Cultural Distance	0.0381	0.644	-0.124	0.243	0.0698	0.175
	(1.094)	(1.761)	(1.104)	(1.257)	(0.787)	(1.270)
Difference in Shareholder Protection between Countries	-0.0929	-1.721	-0.0447	0.185	-0.193	-3.002**
	(1.291)	(1.838)	(1.282)	(1.372)	(1.205)	(1.333)
Difference in GDP per Capita between Countries	3.090*	1.050	2.921*	2.963*	3.299**	2.401
	(1.691)	(7.229)	(1.688)	(1.720)	(1.602)	(1.904)
Difference in Size between Acquiror and Target	2.164**	4.884***	2.093**	2.208**	2.525***	-1.315*
	(0.887)	(1.724)	(0.878)	(0.895)	(0.370)	(0.716)
Acquiror ROA	-0.876	7.748	-0.0779	0.174	-0.398	-23.02*
	(15.83)	(22.62)	(15.80)	(16.02)	(5.657)	(12.81)
Target ROA	21.16	23.52	20.83	23.77	-2.814	
	(26.83)	(31.03)	(26.90)	(27.34)	(6.553)	
Acquiror Debt Ratio	-16.60**	-43.81**	-15.83**	-16.62**	-4.678	0.794
	(7.600)	(18.87)	(7.670)	(7.699)	(2.973)	(6.257)
Target Debt Ratio	1.718	40.43*	1.618	1.463	-2.814	
	(5.620)	(23.25)	(5.619)	(5.732)	(2.415)	
Acquisition Experience	-0.403*	-0.655*	-0.387*	-0.479**	-0.244***	-0.104
	(0.228)	(0.336)	(0.229)	(0.232)	(0.0933)	(0.306)
State-Owned Acquiror	1.153	-2.680	-1.500	-1.200	-13.89**	16.90*
	(14.79)	(21.04)	(16.81)	(16.79)	(6.566)	(10.20)
Stake Sought	0.399***	0.318	0.403***	0.404***	0.512***	0.385***
	(0.0849)	(0.245)	(0.0858)	(0.0864)	(0.0412)	(0.104)
Completed Deal	10.55**	13.14**	10.57**	10.11**	4.429**	10.41**
	(4.552)	(6.057)	(4.260)	(4.326)	(1.941)	(5.096)
Multiple Bidders	15.70***	25.53***	15.77***	14.88***	10.70***	14.33***
	(4.161)	(6.110)	(4.162)	(4.223)	(2.053)	(4.767)
Tender Offer	7.093***	9.936**	6.875***	7.017***	3.850***	6.214**
	(2.672)	(4.406)	(2.628)	(2.710)	(1.168)	(2.834)
Cash Payment	1.620	2.829	1.729	1.787	4.102***	4.521
	(2.720)	(4.326)	(2.699)	(2.772)	(1.175)	(2.800)
Financial Acquiror	1.213					
	(6.700)					
Hostile Acquisition	0.00406					
	(4.420)					
Horizontal Acquisition	1.137					
	(2.630)					
Acquisition Prediction				0.109		
				(0.191)		
Constant	3.060	6.452	1.022	-15.22	3.050	-31.98**
	(20.45)	(28.04)	(20.57)	(18.58)	(10.30)	(15.37)
Observations	925	941	915	895	5592	930
R-squared	0.121	0.119	0.116	0.117	0.108	0.069

Robust standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

Sector and year fixed effects are included in each regression.

OLS estimation with robust standard errors (i.e. Huber/White/sandwich estimator of variance) is applied.

In the model 1, we include few more control variables. In the model 2, we use the final bid premium as a dependent variable.

In the model 3, we lag one year the political affinity variable. In the model 4, we add the predicted number of M&As as a regressor.

In the model 5, we add domestic deals to our sample. In the model 6, we estimate the bid premium

based on a matched sample of domestic and international acquisitions.