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Firm size, sovereign governance, and value creation: Evidence from the acquirer size effect ☆

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ABSTRACT

This paper examines the relationship between acquirer size, sovereign governance, and value-creation in acquisitions. Prior literature indicates that larger acquirers' acquisitions create less shareholder wealth in developed markets, arising primarily from agency and entrenchment problems. However, in weak governance environments, size might have off-setting benefits, including increased market power and political connections. We use a sample of 17,647 takeovers from 45 countries to examine the acquirer size effect around the world. We find that the acquirer size effect exists internationally, but is smaller in magnitude in weak governance markets. Compared with larger acquirers in strong governance countries, large acquirers in weak governance countries do takeovers that generate higher stock-returns and increase post-takeover operating performance. Their deals are also more likely to be friendly, and take less time to complete. We also find that the benefits of larger acquirer size increase with the importance of political connections in the acquirer's country. The results suggest that country-governance can moderate the impact of corporate characteristics, such as corporate size.

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1. Introduction

This paper examines the relationship between country-governance and the size-effect in acquisitions. Prior literature shows that larger acquirers tend to earn lower acquisition-returns in strong-governance countries (Moeller et al., 2004). The argued reason for this finding is that large size can insulate managers from the market for corporate control, leading to managerial entrenchment and value-destruction. However, larger firms could experience several advantages in weaker governance markets. One view is that political connections and market power can be valuable sources of shareholder wealth in weak governance markets. This is largely due to weak governance countries having weak institutions and property rights, with key players, including politicians, wielding significant power without much accountability (Fisman, 2001; Johnson and Mitton, 2003). Such political connections are more likely to exist in large, powerful companies (Farina, 2002), who are better able to exploit these advantages to increase shareholder wealth. Another view, but one with similar valuation outcomes for shareholders, is that in weak governance countries, larger size serves to protect firms from

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possible expropriation and government corruption. Under this view, firms have incentives to increase in size over time as a means of adapting to their environment (Granovetter, 1995; Guiso and Rustichini, 2011; Khanna and Yafeh, 2007; Lucas, 1978).

In well-governed and regulated markets, companies are better protected from sovereign rent-seeking and expropriation, so larger size is likely to be less valuable in protecting shareholder wealth. Indeed, the economics and finance literature has generally focused on large size as a source of value destruction and agency conflicts in well-governed open economies (Baumol, 1962; Jensen, 1986). For example, in analyzing takeover returns, Moeller et al. (2004) report average losses of $25 million for large acquiring firms in the USA over the period 1980–2001. Further, Moeller et al. (2005) show that a relatively small number of large firms account for takeover losses of over $240 billion during the period 1998–2001. The scale of the shareholder value-destruction through takeovers by large firms is interesting given that the USA is one of the most highly rated countries on a range of governance metrics, including the International Country Risk Guide (ICRG) and the World Bank (WB). One of the explanations given for such an effect is that in a strong governance country, such as the USA, firm size serves to entrench managers from external discipline from the market for corporate control (c.f. Offenberg, 2009). Noteworthy, however, is that while the losses experienced by large acquiring firms in the USA are well documented, there is a dearth of evidence on the comparative value-implications of corporate size in an international context.

This paper examines whether and why the acquirer size effect in acquisitions varies with the governance of the acquirer's country. Our main empirical investigation begins with an examination of the relation between acquisition returns and the interaction of firm size with sovereign governance indices across our sample of 45 countries. We show that large acquiring firms tend to earn lower acquisition returns than do smaller acquiring firms, consistent with the presence of agency conflicts and managerial entrenchment. However, compared with large acquirers in strong governance countries, large acquirers in weak governance countries perform significantly better, even after controlling for a range of firm, industry, country, and time-specific factors. We hypothesize that this is because while large firms in weak governance countries may still suffer from agency conflicts related to managerial entrenchment, the benefits of large size in those countries may at least partially off-set agency-related costs.

We next explore several of the value-drivers in large-firms' acquisitions. We provide some evidence suggesting that there are fewer barriers to completing takeovers by larger acquirers in weak governance countries: their deals take significantly less time to complete (controlling for other factors), than those of large acquirers in strong governance countries. Furthermore, whereas larger acquirers (compared to smaller) in stronger governance countries are more likely to be involved in costly hostile takeovers, we find that for weaker governance countries, larger size actually increases the likelihood of doing a friendly deal, which we know from our analysis, is significantly more value-enhancing. Our analysis of takeover premiums provides no evidence that the benefits of large size merely reflect expropriation from the target firm's shareholders (as opposed to actual value-creation). Further, large firms in weak governance markets do takeovers that are more likely to increase operating performance than are their counterparts in strong governance markets.

We also provide some additional evidence to support the view that political connections are an important value driver for larger firms in weak governance countries. We use political connection data from Faccio (2006) to examine the importance of corporate size in countries where corporate-political connections appear to be especially prevalent. We find that the benefits of large size increase significantly with the importance of political connections in a given country, implying that larger firms' deals might benefit from their connections, or at least their ability to navigate environments where connections and political issues are especially important. We also confirm this by examining sub-samples of deals (i.e. domestic deals and diversifying deals) where political connections are most likely to be important.

The results contribute to the takeover and the corporate organization literature by shedding new light on the size-effect in acquisitions. We find evidence of a size-effect in acquirer returns that extends internationally, supporting the argument that agency and managerial entrenchment costs increase with firm size. However, large acquirers in weak governance countries perform significantly better (or at least less poorly) than do large acquirers in strong governance countries. This suggests that large firms in weak governance countries enjoy some advantages, which at least partially off-set the agency-cost implications of corporate size. We provide some evidence that political connections can help to off-set the agency-related factors that are associated with large size. We also conduct a number of robustness tests, including using different definitions of firm size and measures of abnormal returns, and confirm that our results are robust to model specification issues. We also control for some other potential sources of heterogeneity that may explain our results, including controls for firm-level governance, and the quality of target country governance on takeover returns. We find that our results continue to hold in these robustness tests.

The outline of this paper is as follows. Section 2 discusses the prior literature and develops the hypotheses. Section 3 presents the data and defines the variables. Section 4 contains the empirical analysis of the impact acquirer size on acquisition performance. This section also discusses several robustness tests. Section 5 concludes.

2. Hypothesis development

Takeovers are an event in which an acquirer might benefit from being a larger firm in a weak governance environment. Corporations in weak governance environments can generate value by extracting rents from the government (Chen, 2013; Fisman, 2001), and by exploiting their market power to extract rents from other market participants. Larger and 'more powerful' companies are usually more politically connected (Faccio et al., 2006) and have greater market power, allowing them to extract higher rents. Strong governance is one way to reduce rents from the government (Faccio, 2006) or from market power (Khanna and Palepu, 2000). For several reasons, this would suggest that larger firms in weak governance environments enjoy several benefits that would at least partially off-set the agency-cost implications of corporate size.

First, political connections can help facilitate merger approval in developing and transitioning economies (Zheng and Singh, 2010; Zhiang et al., 2009). Faccio (2010) finds that larger firms generally have more political connections. Thus, to the extent that large firms are more connected, large firms in weak-governance environments could use political connections to facilitate the takeover process and obtain government approval. Similarly, social ties can help to facilitate deals in weak-governance countries (Ellis, 2011), and such social networks become increasingly important as governance worsens (Roy and Oliver, 2009). To the extent that larger firms are generally seen as more 'prestigious' and tend to attract managers who are more connected (see e.g. Masulis and Mobbs, 2014), large firms should be most able to leverage social ties.

Second, political connections (which concentrate in large firms) can yield acquirer-benefiting takeovers because: (a) prestige, status and political power tend to induce a more positive target response (D'Aveni and Kesner, 1993), and this should be more important in weak-governance environments; and (b) there is some evidence of forced takeovers in weak governance environments and these tend to benefit larger more connected firms (MacIntyre, 2003; Volkov, 2004).

Third, given that business groups generate corporate value in weak-governance environments (He et al., 2013), large firms could use their dominant position as a form of non-pecuniary acquisition currency with which to entice target-firm shareholders (Khanna, 2000).

Fourth, given that (a) lenders in weak governance requirements often require high levels of asset-backed collateral (Menkhoff et al., 2006), and (b) large firms are more able to satisfy this requirement, large firms might be best able to finance takeovers. This advantage should concentrate in weak governance environments where collateral is more important.

Fifth, large size is a protective mechanism that is 'adapted' to weak governance environments and is relatively less useful in good governance environments. For weak governance environments, organizations may increase in size as a way to protect themselves from government intervention and political instability (Granovetter, 1995; Khanna and Yafeh, 2007). This is particularly important where the governance environment, weak contract law, and the lack of the rule of law may make external transactions risky (consistent with Chang and Hong, 2000; Khanna and Palepu, 2000; Khanna and Yafeh, 2007). Subsequently, there is some related evidence that resource-rich parties tend to perform better in litigation in emerging markets (He and Su, 2013). However, this 'protection' aspect of large size is mainly adapted to weak governance environments. Thus, it becomes less useful in strong governance environments, where large size may offer 'excess' protection from external market forces, and may enable managers to act on agency conflicts (Humphery-Jenner and Powell, 2011; Moeller et al., 2004, 2005). Subsequently, the 'excess' protection from market forces in strong governance countries might destroy shareholder wealth. This suggests that while large size increases shareholder wealth by protecting firms in weak governance countries, in good governance countries it might destroy shareholder wealth by offering excess managerial protection and reducing managerial discipline. This background enables us to make the following 'value-creation' hypothesis.

Hypothesis 1. *Value-creation hypothesis*. The market will react more positively (or at least less negatively) to deals made by large companies in weak governance countries as compared with those made in strong governance countries.

We next consider several possible reasons for why the market might respond more favorably to large acquirers' acquisitions. First, larger firms might be able to use their connections and resources to reduce the time required to complete a deal. Reducing completion times can be value-creating given that (a) acquisitions are often costly due to the presence of financial intermediaries (see e.g. Krishnan et al., 2012; Krishnan and Masulis, 2013), and (b) the longer a deal remains open the more scope there is for a competing bidder to place a bid, thereby increasing acquisition premiums and creating the risk of a winner's curse (Boone and Mulherin, 2008; Giliberto and Varaiya, 1989). The 'completion time' hypothesis captures this prediction.

Hypothesis 2. *Completion-time hypothesis*. In weak governance countries, larger firms take less time to complete a deal, compared to large in stronger governance countries.

Second, larger acquirers in weak governance countries might be more able to undertake a 'friendly' deal than larger in strong governance countries. This might arise for several reasons, including political connections, increased market power, and greater financial resources. These factors might encourage a potential target to acquiesce to a deal rather than to compete with the bidder. Further, a larger firm might be more able to finance an adequate takeover premium, which would reduce the likelihood of deal-resistance. Subsequently, we make the following 'deal mood' hypothesis.

Hypothesis 3. *Deal-mood hypothesis*. In weak governance countries, larger firms will be more likely to undertake a 'friendly' deal compared to larger firm in strong governance countries.

Third, it might be possible that larger firms' acquisitions in weak governance countries (compared with those in strong governance countries) perform better because they are able to use their market-position to pay lower premiums and 'expropriate' wealth from the target's shareholders. The simple fact of paying lower takeover premiums could result in the market responding more positively to large firms' acquisitions in poor governance countries. We capture this with the 'takeover premium' hypothesis.

Hypothesis 4. *Takeover premium hypothesis*. Large firms in weak governance countries pay lower takeover premiums than do large firms in strong governance countries.

We further anticipate that in weak governance countries, large firms will have some advantages over their counter parts in strong governance countries due to the utility of political connections. While political connections (and expenditures) are

important in developed markets (Coates, 2012), they are significantly more important in comparatively weak governance markets (Brockman et al., 2013; Chen et al., 2010). Subsequently, in weak governance markets, we hypothesize that firm size is important in those types of deals where government intervention is more likely to be important. First, government connections are likely to be more important when the firm is undertaking a domestic takeover for another firm in the bidder's country than it is for a cross-border deal. Second, government-intervention is likely to have the most adverse consequences for diversifying deals, as the government directs diversifying acquisitions which do not create shareholder wealth (Fan et al., 2008). Given that we expect that large firms in weak governance markets will be more able to resist such government intervention, we expect that they will perform comparatively better in these diversifying deals. We also examine the role of acquirer size in countries where political connections are more dominant in corporate boards, on average.

Hypothesis 5. *Connections hypothesis*. In weak governance countries, larger size is helpful in those types of deals that are more likely to rely on connections (although, this does not mean that large size is not important in other types of deals). The benefits of larger size should increase with the importance of political connections in the acquirer's country.

Improvements in operating performance (as opposed to simply obtaining a cheap target) can be a key source of value-creation. We expect that larger firms in weak governance countries will do takeovers that are more likely to increase long-run operating performance. A value-creating takeover should both be associated with a more positive market reaction and should increase operating performance (Harford et al., 2012; Healy et al., 1992; Li, 2013; Powell and Stark, 2005). We expect that large firms in weak governance countries will be more likely to experience operating improvements than their counterparts in strong governance countries. This is because (from the foregoing discussion) while large firms in both weak governance and strong governance countries might suffer agency conflicts of managerial-entrenchment, large size conveys some additional wealth-enhancing benefits in weak governance countries. These benefits will at least partially off-set some of the agency costs related to large size. Examining operating performance also has the empirical benefit of helping to validate the short-run market-returns results with longer-run results. Subsequently, we make the following hypothesis.

Hypothesis 6. *Operating performance hypothesis*. Large firms in weak governance countries are more likely to do takeovers that increase operating performance than are large firms in strong governance countries.

3. Data

The full sample comprises of 17,647 takeover observations from 45 countries. The takeover data is extracted from Thomson's SDC platinum and we analyze takeovers announced between 1996 and 2008. The results are robust to excluding the financial crisis year 2008, and years associated with the Asian Financial Crisis. We obtain stock-return data from Datastream. Acquirer level financial data is extracted from Worldscope. Governance data is taken from the World Bank's governance indicators site and from the International Country Risk Guide (ICRG). We restrict the sample to takeovers that are for at least USD 1 m, are completed, and for which the acquirer owns less than 50% of the target before the takeover and holds 100% of the target after (consistent with Masulis et al., 2007; Harford et al., 2012). Table A1 in Appendix 1 contains a detailed description of the variables and their calculation.

3.1. Dependent variables

We use the acquirer's cumulative abnormal return (CAR) around the acquisition announcement as a proxy for whether the deal creates value. We use an 11-day market-adjusted CAR. We choose an 11-day window because some markets have weak stock exchange rules, giving rise to potential leakage and pre-takeover informed trade, which a longer window will capture. Using alternative windows (e.g., 3-day, 5-day, 21-day) does not alter our findings (untabulated). The market return is the return earned on the market index for the firm's market as indicated in DataStream. We used a market-adjusted model over a market model because many of the deals in our sample occur in countries with fairly illiquid markets. This illiquidity could bias the estimation of market model parameters (Dimson, 1979; Dimson and Marsh, 1983). Nevertheless, in untabulated results, our findings are robust to using market model based CARs, where the model parameters (alpha and beta) are estimated using OLS regressions over 200 days (−210, −11) prior to the takeover announcement for each firm. We also use methods (untabulated) advocated by Dimson (1979) and Scholes and Williams (1977) to adjust the market model parameters for non-synchronous trading, and find results consistent with our market-adjusted models. For brevity and reporting convenience, we only tabulate results using the market-adjusted model.

We collect data from SDC on the time-to-completion and the deal mood in order to address Hypothesis 2 and Hypothesis 3. We measure the time to completion (the dependent variable) as the time between the announcement of the deal and the completion of the deal. We capture the deal mood by creating an indicator that equals one if the deal is 'friendly' (i.e. is not hostile, as reported in SDC).

We measure the takeover's long run operating performance by obtaining data on the acquirer's EBIT/Assets in the years after the acquisition (in order to address Hypothesis 6). We create indicators for whether the acquirer's EBIT/Assets 1, 2, or 3 years after the takeover exceeds its EBIT/Assets 1-year before the takeover announcement (for three variables in total).

3.2. Size and control variables

The key independent variable is the acquirer firm size variable, defined as the natural log of the firm's book assets, denoted 'ln(Assets)'. Using the natural log of the firm's market capitalization does not alter our findings. We also include a number of control variables that are standard to the literature (see, e.g., Harford et al., 2012; Humphery-Jenner and Powell, 2011; Moeller et al., 2004, 2005; Masulis et al., 2007; Travlos, 1987). Specifically, we include relative size of the target, Tobin's q, return on assets, capital expenditures, free cash flow, leverage, and indicator variables for diversifying deals, all cash, all stock, target organizational status (i.e., public, private or subsidiary), competed deals, and friendly deals. We also control for country-level characteristics to ensure that sovereign governance does not merely proxy for country-level growth characteristics. We include the market capitalization of the home market scaled by GDP (at the end of the prior year), the stock turnover ratio in the home market over the course of the prior year, and the amount of FDI, unemployment, and the trade imbalance in the prior year. The country-level variables are sourced from the World Bank.

3.3. Governance variables

We use governance variables that capture government-based expropriation and corruption. Note that we do not focus on shareholder protection. This is because we analyze the use of corporate size as a mechanism of protection from the government. Measures of shareholder protection would not capture this type of government corruption.

We use World Bank governance variables, which capture different types of government corruption and risk, and have also received extensive use in the literature (Apodaca, 2004; Braun and Di Tella, 2004; Dollar and Kraay, 2003; Neumayer, 2002; Thomas, 2010). We focus on these measures of country governance because they reflect varying types of corruption, government effectiveness, and the rule of law. We do not focus on the ADRI indices (cf La Porta et al., 1997; Spamann, 2010) because they only capture shareholder protection, and do not capture government expropriation, which is the focus of this study. They are also time invariant, so will not capture changes due to financial liberalization. By contrast, the World Bank variables are available in most years.[3]

The first governance variable is the World Bank governance variable. The World Bank variable is based on six World Bank sub-variables. The six World Bank variables are percentile ranks in terms of accountability, government effectiveness, political stability, regulation, the rule of law, and corruption. We compute a composite governance index (WB governance index), which is the equally weighted average of these six percentile ranks. We also use the ICRG political risk index. These variables capture (weak) sovereign risk. In all cases, a higher governance score indicates stronger governance.

3.4. Political connection measures

We obtain the political connection measures from Faccio (2006), as indicated above. We focus on the level of political connections at the aggregate country level. We do this for two reasons. First, it allows us to use the data in Faccio (2006) for the full time-period under-analysis. If we were to use the firm-specific data in Faccio (2006), then we would be limited to the set of firms that existed at the time of the study. Second, using sovereign-level data allows us to avoid concerns about endogeneity between corporate size and political connections.

We use three proxies for the importance of political connections in the acquirer's country. First, we use the percentage of all firms that had as one of their top officers a member of parliament or head of state. Second, we use the percentage of all firms who satisfy the first definition, or had a top officer who was a close relative of a member of parliament or head of state. Third, we use the percentage of the top 50 firms (by market capitalization) who have a top officer who is either a member of parliament or a head or state, or is a close relative thereof. The percentages are based on the sample of all Worldscope firms.

3.5. Univariate analysis and sample description

The sample composition by year is reported in Table 1. The summary statistics for the variables are reported in Table 2. All continuous variables are winsorized at the 1% level by country. We report CARs and $CARs using both the market-adjusted model (MAM) and the market-model (MM). The positive average CARs of 1.31% (MAM) or 1.92% (MM) reported in Table 1 are consistent with prior studies and suggest that acquiring firms, on average, gain from takeovers. The higher mean CARs for the MM confirm our illiquidity concerns with respect to some of the less well-developed economies in our sample. More specifically, in markets that suffer from illiquidity problems, stocks may not trade on a daily basis, so beta estimates from a market model will be biased downwards (Dimson, 1979; Dimson and Marsh, 1983), giving rise to lower expected returns, and higher abnormal returns. Nevertheless, both MAM and MM CARs are positive and statistically significant. However, we find differences in the sign for $CARs, with negative average values ($1.65 m) for MAM returns, and positive ($0.40 m) for the MM returns. Given our concerns about illiquidity, we place more confidence on the MAM values, so on the basis of the negative $CAR, we conclude that our results confirm the existence of a size-effect across our sample. Table 1 also shows some variation in takeover activity over time, with higher activity and clustering during the late 1990s, and again during the 2004–2007 period (Ahern and Harford, forthcoming; as per Andrade et al., 2001; Powell and Yawson, 2005). The statistics show the existence of some large dollar losses in takeovers during the 2000 and 2001 period, which overlaps with

[3] The World Bank provides figures for 1996, 1998, 2000, 2002, 2003, 2004, 2005, 2006, 2007, and 2008. For the years with missing data we use the figure from the most recent prior year.

Table 1
Summary statistics by year. This table reports mean sample statistics by year. The term %CAR is the 11-day CAR in percentage terms, measured from 5 days before the takeover announcement date to 5 days after. MAM and MM denote abnormal returns calculated using a market-adjusted model and a market model, respectively. The variable $CAR is the 11-day dollar car inflated to US$m 2009. Market capitalization and assets inflated to US$ 2009, and are reported in millions.

Year	No. of observations	%CAR MAM	%CAR MM	$CAR MAM	$CAR MM	Market capitalization	Assets
1996	1023	1.757	1.895	13.287	12.934	2014	1566
1997	1517	1.417	1.444	−6.142	−4.688	3028	1820
1998	1879	1.140	1.582	6.068	5.489	3184	2180
1999	1462	1.264	1.441	2.517	−3.380	9322	3552
2000	1568	0.254	1.301	−51.301	−48.040	11,869	3671
2001	915	−0.094	1.786	−18.106	−21.452	7801	2702
2002	963	0.201	1.963	1.660	22.257	2789	2209
2003	984	2.063	2.821	−5.909	5.858	4121	2413
2004	1359	1.807	2.073	−9.443	−6.619	12,987	2391
2005	1556	2.080	2.152	10.136	7.768	4935	3498
2006	1630	1.927	2.215	−0.971	−2.267	4216	3272
2007	1672	1.747	2.546	20.309	23.297	4293	3724
2008	1119	0.737	2.103	−7.643	−3.738	3329	2665
Total	17,647	1.306	1.923	−1.647	0.395	5647	2812

the time period of large losses as reported by Moeller et al. (2005) for the USA market. However, as we will see later, large losses are not solely driven by the USA market. To control for unobserved year effects, we use year dummies in our regression models.

Table 2 reports summary statistics for the variables used in our multivariate regression models. The WB composite index and the ICRG political index (Panel A) have mean values of 0.89 and 0.84 respectively, indicating that on average, governance levels are fairly high. Some variation is evident, however, with reported standard deviations of 0.08 and 0.05, respectively. Other acquirer and deal characteristics are fairly consistent with prior studies, except that given the nature of our sample we report a much higher proportion of cross-border deals at 26% and diversifying deals at 67%.

Table 2
Summary statistics for model variables. The table reports summary statistics for CARs, governance, acquirer, deal, and country-level characteristics for the pooled sample. Detailed variable definitions are reported in Appendix 1 (Table A1).

Variable	Mean	Median	Standard Deviation	Number of Obs.
Panel A: Governance indices				
WB governance index	0.888	0.909	0.082	17,647
ICRG political index	0.844	0.855	0.050	17,459
Panel B: Acquirer financial and deal characteristics				
%CAR (Market-adjusted model, MAM)	1.306	0.778	8.228	17,647
%CAR (Market model, MM)	1.923	0.895	7.949	17,647
$CAR (MAM, US$m, 2009)	−1.647	1.265	296.713	14,582
$CAR (MM, US$m, 2009)	0.395	1.435	287.772	14,582
Market capitalization (US$m, 2009)	5647	478	95,828	14,582
Assets (US$m, 2009)	2812	441	11,670	17,647
Relative size	0.238	0.083	0.457	17,647
Return on assets	0.082	0.110	0.180	17,647
Leverage (market)	0.175	0.134	0.168	17,647
Cash-holdings	0.145	0.075	0.174	17,647
CAPEX	0.065	0.038	0.082	17,647
Diversifying deal	0.672	1	0.470	17,647
Competed	0.008	0	0.086	17,647
Tender offer	0.044	0	0.205	17,647
Friendly	0.985	1	0.123	17,647
Cross-border	0.259	0	0.438	17,647
Cash only	0.260	0	0.439	17,647
Stock only	0.140	0	0.347	17,647
Mixed	0.600	1	0.490	17,647
Public	0.126	0	0.332	17,647
Private	0.528	1	0.499	17,647
Subsidiary	0.346	0	0.476	17,647
Days to completion	52.54	27	75.37	17,646
Panel C: Country-level financial characteristics				
Home market capitalization (%)	1.309	1.371	0.444	17,647
Home stock turnover (%)	106.213	103.200	47.223	17,647
FDI (%)	0.028	0.020	0.049	17,647
Unemployment (%)	5.656	5.200	2.011	17,647
Trade imbalance	5.271	5.477	8.773	17,647

Table 3 reports the CARs and governance-indexes by country. The CARs are based on a market adjusted approach (MAM). The table shows that there is significant variation in CARs across countries, largely varying with the quality of the governance in that country. There is significant variation in country-level governance. The components of the World Bank governance index largely move together, suggesting a high level of correlation between the different aspects of governance.

We compare the CARs accruing to large firms in good governance countries with large firms in weak governance countries in Table 4. In Table 4, we split the sample into terciles, quartiles, and quintiles in terms of the firm's assets and the World Bank governance score for the firm's country. We report the mean and median CAR and the number of observations for each group. The CARs are the 11-day market-adjusted CARs. We split the sample into acquirer-size groups and within each group look at the CARs in each governance sub-group. For example, within asset tercile 3 (i.e. the top 33% of acquirers in terms of size), we analyze CARs for each of the governance terciles. We present the difference-in-CARs between the worst governance group and the best governance group. There are two key findings. First, large acquirers tend to perform worse than do small acquirers. This is consistent across governance-groups. Thus, we find evidence of a size-effect internationally. Second, for the large acquirers (i.e. top tercile, quartile, or quintile), firms in weaker governance countries earn higher CARs than do firms in stronger governance countries. That is, the size effect is less pronounced. Overall, this indicates that while the size effect exists outside of the USA, large acquirers perform comparatively less poorly in weak governance countries. This suggests that large size could convey benefits in weak governance countries that at least partially off-set the agency-related disbenefits of large acquirer size.

Table 3
Summary statistics for CARs and country-governance by country.

Acq. nation	Obs.	CAR	WB Gov Accountability	WB Gov Anti-corruption	WB Gov Effectiveness	WB Gov Political stability	WB Gov Regulation	WB Gov Rule of law	WB Gov index	ICRG Political index
Argentina	6	2.734	0.575	0.424	0.530	0.486	0.236	0.387	0.439	0.697
Australia	1405	3.393	0.943	0.948	0.956	0.820	0.956	0.954	0.929	0.872
Austria	28	0.832	0.923	0.947	0.932	0.881	0.939	0.970	0.932	0.866
Belgium	57	2.353	0.935	0.909	0.925	0.766	0.899	0.904	0.890	0.832
Brazil	67	0.158	0.605	0.559	0.532	0.390	0.558	0.450	0.516	0.662
Canada	1216	−1.546	0.959	0.947	0.961	0.856	0.931	0.952	0.934	0.867
Chile	10	4.113	0.805	0.888	0.869	0.732	0.910	0.865	0.845	0.780
China	91	4.743	0.057	0.376	0.608	0.342	0.444	0.436	0.377	0.686
Colombia	1	−3.727	0.394	0.539	0.536	0.048	0.546	0.305	0.395	0.580
Denmark	61	3.650	0.986	0.986	0.990	0.843	0.980	0.987	0.962	0.871
Finland	115	1.399	0.988	0.998	0.981	0.988	0.975	0.984	0.986	0.934
France	269	1.789	0.887	0.906	0.900	0.683	0.838	0.899	0.852	0.782
Germany	165	0.380	0.928	0.940	0.931	0.851	0.924	0.936	0.918	.
Greece	11	2.564	0.766	0.648	0.721	0.621	0.756	0.729	0.707	0.767
Hong Kong	165	1.418	0.584	0.906	0.908	0.821	0.981	0.874	0.846	0.790
Hungary	1	−4.462	0.875	0.718	0.754	0.764	0.844	0.733	0.781	0.815
Iceland	8	0.214	0.976	0.996	0.989	1.000	0.957	1.000	0.986	0.905
India	37	0.466	0.608	0.451	0.517	0.228	0.442	0.584	0.472	0.616
Indonesia	5	9.585	0.430	0.266	0.439	0.133	0.396	0.269	0.322	0.576
Ireland-Rep	138	0.496	0.929	0.920	0.918	0.908	0.971	0.930	0.929	0.893
Israel	61	1.284	0.682	0.820	0.839	0.131	0.806	0.772	0.675	0.628
Italy	93	1.687	0.799	0.690	0.735	0.636	0.776	0.683	0.720	0.788
Japan	597	1.853	0.779	0.860	0.875	0.847	0.812	0.892	0.844	0.826
Jersey	1	−18.279	0.928	0.937	0.943	0.673	0.981	0.924	0.898	0.830
Luxembourg	3	3.439	0.960	0.940	0.946	0.989	0.987	0.970	0.965	0.930
Malaysia	188	1.251	0.373	0.661	0.801	0.561	0.666	0.643	0.618	0.733
Mexico	25	0.298	0.528	0.474	0.615	0.351	0.641	0.401	0.502	0.723
Netherlands	125	1.395	0.985	0.972	0.970	0.867	0.977	0.948	0.953	0.887
New Zealand	66	1.820	0.982	0.988	0.944	0.955	0.964	0.969	0.967	0.886
Norway	129	3.417	0.980	0.958	0.975	0.940	0.906	0.991	0.958	0.884
Peru	4	5.433	0.494	0.487	0.371	0.191	0.579	0.282	0.401	0.628
Philippines	34	0.810	0.505	0.322	0.513	0.212	0.540	0.424	0.419	0.649
Poland	18	−1.215	0.734	0.657	0.688	0.693	0.727	0.631	0.688	0.777
Portugal	13	3.224	0.906	0.840	0.814	0.832	0.842	0.837	0.845	0.844
Russian Fed	23	−3.625	0.226	0.183	0.432	0.228	0.327	0.189	0.264	.
Singapore	136	2.024	0.479	0.980	0.994	0.899	0.992	0.929	0.879	0.856
South Africa	76	3.604	0.713	0.685	0.772	0.340	0.648	0.566	0.621	0.679
South Korea	93	3.583	0.672	0.689	0.844	0.595	0.732	0.751	0.714	0.766
Spain	87	1.629	0.859	0.864	0.849	0.554	0.865	0.851	0.807	0.799
Sweden	245	2.485	0.973	0.979	0.975	0.928	0.939	0.973	0.961	0.895
Switzerland	84	2.693	0.956	0.966	0.989	0.979	0.944	0.990	0.971	0.889
Thailand	25	1.299	0.506	0.497	0.637	0.372	0.608	0.563	0.530	0.671
Turkey	2	−8.559	0.416	0.601	0.632	0.211	0.593	0.547	0.500	0.630
United Kingdom	3207	1.865	0.899	0.954	0.947	0.722	0.976	0.944	0.907	0.861
United States	8456	0.951	0.900	0.922	0.932	0.750	0.942	0.927	0.896	0.843
Total	17,647	1.306	0.883	0.916	0.927	0.757	0.928	0.917	0.888	0.844

Table 4
CARs by governance and size tercile, quartile, and quintile. This table contains the mean and median acquirer CAR split by size and World Bank governance tercile, quartile, or quintile. The CARs are market-adjusted model acquirer CARs computed over the 11-day window surrounding the acquisition announcement. Superscripts ***, **, and * denote significance at 1%, 5%, and 10%, respectively.

	Mean	Median	N		Mean	Median	N		Mean	Median	N
Assets Tercile 3				Assets Quartile 4				Assets Quintile 5			
Gov Tercile 1	0.756	0.466	2451	Gov Quartile 1	0.633	0.379	1525	Gov Quintile 1	0.497	0.315	1052
Gov Tercile 2	0.277	0.131	2239	Gov Quartile 2	0.733	0.420	1143	Gov Quintile 2	0.804	0.688	655
Gov Tercile 3	0.080	0.082	1192	Gov Quartile 3	−0.212	−0.145	866	Gov Quintile 3	−0.536	−0.384	805
Overall	0.437	0.333	5882	Gov Quartile 4	0.106	0.072	877	Gov Quintile 4	−0.100	−0.161	431
				Overall	0.388	0.240	4411	Gov Quintile 5	0.200	0.496	584
								Overall	0.196	0.140	3527
Gov Tercile 1 − Gov Tercile 3	0.676**	0.383***		Gov Quartile 1 − Gov Quartile 4	0.527*	0.307***		Gov Quintile 1 − Gov Quintile 5	0.297**	−0.181***	
Assets Tercile 2				Assets Quartile 3				Assets Quintile 4			
Gov Tercile 1	1.569	1.139	1985	Gov Quartile 1	1.372	0.862	1230	Gov Quintile 1	1.386	0.733	849
Gov Tercile 2	1.395	0.853	2563	Gov Quartile 2	1.207	0.816	1255	Gov Quintile 2	1.126	0.810	661
Gov Tercile 3	0.543	0.445	1334	Gov Quartile 3	1.100	0.514	1026	Gov Quintile 3	0.800	0.550	799
Overall	1.260	0.908	5882	Gov Quartile 4	−0.003	0.009	898	Gov Quintile 4	0.877	0.329	613
				Overall	0.982	0.643	4409	Gov Quintile 5	−0.006	−0.048	609
								Overall	0.876	0.568	3531
Gov Tercile 1 − Gov Tercile 3	1.026	0.694		Gov Quartile 1 − Gov Quartile 4	1.375	0.853		Gov Quintile 1 − Gov Quintile 5	1.392	0.781	
Assets Tercile 1				Assets Quartile 2				Assets Quintile 3			
Gov Tercile 1	2.507	1.611	1638	Gov Quartile 1	1.431	1.004	1063	Gov Quintile 1	1.540	0.963	756
Gov Tercile 2	1.846	1.022	2229	Gov Quartile 2	1.545	1.095	1314	Gov Quintile 2	1.722	1.210	675
Gov Tercile 3	2.403	2.187	2016	Gov Quartile 3	2.006	1.291	962	Gov Quintile 3	1.162	0.912	840
Overall	2.221	1.481	5883	Gov Quartile 4	1.262	1.086	1076	Gov Quintile 4	1.485	0.838	650
				Overall	1.549	1.110	4415	Gov Quintile 5	0.320	0.408	609
								Overall	1.264	0.928	3530
Gov Tercile 1 − Gov Tercile 3	0.104***	−0.576**		Gov Quartile 1 − Gov Quartile 4	0.170	−0.082		Gov Quintile 1 − Gov Quintile 5	1.221	0.555	
				Assets Quartile 1				Assets Quintile 2			
				Gov Quartile 1	2.481	1.352	721	Gov Quintile 1	1.983	1.136	656
				Gov Quartile 2	2.150	1.337	1332	Gov Quintile 2	2.167	2.010	717
				Gov Quartile 3	2.292	1.344	854	Gov Quintile 3	0.729	0.271	705
				Gov Quartile 4	2.366	2.365	1505	Gov Quintile 4	2.578	1.874	717
				Overall	2.305	1.556	4412	Gov Quintile 5	1.673	1.680	734
								Overall	1.826	1.339	3529
				Gov Quartile 1 − Gov Quartile 4	0.115***	−1.013		Gov Quintile 1 − Gov Quintile 5	0.311*	−0.543	
								Assets Quintile 1			
								Gov Quintile 1	2.248	1.396	435
								Gov Quintile 2	2.557	1.586	800
								Gov Quintile 3	2.321	1.415	606
								Gov Quintile 4	1.975	1.275	712
								Gov Quintile 5	2.581	2.379	977
								Overall	2.368	1.575	3530
								Gov Quintile 1 − Gov Quintile 5	−0.333**	−0.983	

4. Results and analysis

4.1. Size, governance and CARs (Hypothesis 1)

The goal is to examine how sovereign governance moderates the impact of firm size on takeover profitability. The expectation is that larger firms perform better in weak governance countries. We capture this expectation in the following model.

$$\mathrm{CAR}_j = \alpha + \beta^{(1)} \ln(\mathrm{Assets})_j + \beta^{(2)}\mathrm{GOV}_j + \beta^{(3)}\left(\ln(\mathrm{Assets})_j \times \mathrm{GOV}_j\right) + \boldsymbol{\theta X}_j + \lambda_t + \varepsilon_j. \quad (1)$$

We expect that $\beta^{(3)}$ will be negative, implying that larger acquirers in strong governance countries generally do worse deals. We also examine models where we create dummy variables for whether the acquirer is a 'large' firm, and whether it is in a 'weak'

Table 5
Acquirer announcement returns (CARs) regressions.
The table reports OLS regressions that examine the market's reaction to the firm's takeover decision. The dependent variable is the 11-day market-adjusted CAR. Detailed variable definitions are reported in Appendix 1. The models include year dummies (untabulated). *P*-values calculated using heteroskedasticity-consistent standard errors and corrected for industry-level clustering (using 4-digit SIC industry codes) are reported in parentheses. Superscripts ***, **, and *, denote significance at 1%, 5%, and 10%, respectively.

Dependent variable	11-day %CAR							
Variables	[1]	[2]	[3]	[4]	[5]	[6]	[7]	[8]
Ln(Assets)	0.059	0.057	0.290***	0.293***				
	[0.325]	[0.340]	[0.000]	[0.000]				
WB Gov Index	0.142		5.016***					
	[0.914]		[0.003]					
ICRG Political Index		−0.582		3.854*				
		[0.772]		[0.085]				
Ln(Assets) * WB Gov Index			−0.385***					
			[0.000]					
Ln(Assets) * ICRG Political Index				−0.409***				
				[0.000]				
Size top 25%					−1.228***		−1.125***	
					[0.000]		[0.000]	
Size top 10%						−1.373***		−1.277***
						[0.000]		[0.000]
Weak WB Gov × Size top 25%					0.658**			
					[0.016]			
Weak WB Gov × Size top 10%						0.710*		
						[0.066]		
Weak Political Gov × Size top 25%							0.514**	
							[0.034]	
Weak Political Gov × Size top 10%								0.612
								[0.100]
Weak WB Gov					−0.375	−0.284		
					[0.115]	[0.197]		
Weak Political Gov							0.043	0.103
							[0.826]	[0.569]
Tobin's q	0.262***	0.268***	0.266***	0.273***	0.265***	0.264***	0.267***	0.265***
	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]
Relative size	1.156***	1.155***	0.872***	0.868***	1.045***	1.085***	1.047***	1.089***
	[0.000]	[0.000]	[0.002]	[0.002]	[0.000]	[0.000]	[0.000]	[0.000]
Return on assets	0.946	0.881	1.539***	1.475***	1.188**	1.117*	1.151*	1.081*
	[0.112]	[0.139]	[0.006]	[0.009]	[0.048]	[0.063]	[0.058]	[0.074]
Leverage	−1.483**	−1.532**	−0.627	−0.661	−1.066*	−1.283**	−1.119*	−1.336**
	[0.014]	[0.011]	[0.289]	[0.263]	[0.078]	[0.034]	[0.062]	[0.026]
Cash-holdings	−1.073**	−1.145**	−1.537***	−1.602***	−1.230**	−1.122**	−1.266**	−1.163**
	[0.033]	[0.032]	[0.001]	[0.002]	[0.016]	[0.027]	[0.013]	[0.022]
CAPEX	−4.708***	−4.691***	−4.840***	−4.816***	−5.004***	−4.955***	−4.806***	−4.797***
	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]
Diversifying	−0.052	−0.047	−0.021	−0.02	−0.032	−0.039	−0.038	−0.045
	[0.783]	[0.806]	[0.911]	[0.915]	[0.866]	[0.837]	[0.839]	[0.810]
Competed	−0.021	0.004	0.208	0.243	0.092	0.082	0.101	0.099
	[0.976]	[0.995]	[0.758]	[0.722]	[0.893]	[0.904]	[0.882]	[0.885]
Tender	1.025**	0.943*	0.964*	0.882*	1.021**	1.025**	1.031**	1.023**
	[0.043]	[0.069]	[0.059]	[0.092]	[0.046]	[0.045]	[0.046]	[0.047]
Friendly	−0.429	−0.367	−0.537	−0.465	−0.603	−0.539	−0.544	−0.495
	[0.426]	[0.503]	[0.323]	[0.399]	[0.265]	[0.317]	[0.319]	[0.361]
Cross-border	−0.323*	−0.28	−0.144	−0.099	−0.231	−0.271	−0.222	−0.259
	[0.097]	[0.147]	[0.478]	[0.621]	[0.238]	[0.164]	[0.253]	[0.178]
Cash only	−0.136	−0.123	−0.075	−0.066	−0.094	−0.117	−0.116	−0.135
	[0.367]	[0.410]	[0.611]	[0.649]	[0.521]	[0.433]	[0.438]	[0.369]
Stock only	−0.664***	−0.648***	−0.601***	−0.581***	−0.624***	−0.641***	−0.648***	−0.662***
	[0.003]	[0.004]	[0.007]	[0.009]	[0.005]	[0.004]	[0.003]	[0.003]
Public target	−3.347***	−3.307***	−2.984***	−2.939***	−3.187***	−3.224***	−3.157***	−3.194***
	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]
Private target	−0.406***	−0.381***	−0.628***	−0.601***	−0.552***	−0.515***	−0.543***	−0.503***
	[0.003]	[0.006]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]
Home market capitalization	2.784	−1.285	1.865	−4.007	2.66	2.51	1.46	1.495
	[0.902]	[0.955]	[0.935]	[0.862]	[0.898]	[0.905]	[0.946]	[0.945]
Home turnover	0.12	0.129	0.253	0.254	0.322	0.281	0.224	0.189
	[0.638]	[0.606]	[0.305]	[0.296]	[0.194]	[0.257]	[0.376]	[0.453]
FDI	−1.248	−1.343	−1.262	−1.391	−1.103	−1.186	−1.356	−1.424
	[0.552]	[0.530]	[0.555]	[0.526]	[0.597]	[0.579]	[0.526]	[0.515]

(continued on next page)

Table 5 (*continued*)

Dependent variable	11-day %CAR							
Variables	[1]	[2]	[3]	[4]	[5]	[6]	[7]	[8]
Unemployment	−0.03	−0.03	−0.038	−0.041	−0.026	−0.025	−0.036	−0.036
	[0.498]	[0.544]	[0.410]	[0.407]	[0.561]	[0.567]	[0.420]	[0.421]
Trade imbalance	−2.158*	−2.508*	−1.846	−2.335*	−2.257*	−2.365*	−2.654**	−2.800**
	[0.091]	[0.066]	[0.150]	[0.087]	[0.065]	[0.051]	[0.030]	[0.021]
Constant	1.409	2.042	−2.653	−1.404	2.874***	2.728***	2.819***	2.708***
	[0.454]	[0.389]	[0.221]	[0.585]	[0.000]	[0.000]	[0.000]	[0.001]
Observations	17,647	17,459	17,647	17,459	17,647	17,647	17,647	17,647
Adjusted R^2	2.90%	2.90%	3.30%	3.30%	3.10%	3.00%	3.10%	3.00%

governance country. Specifically, we create three larger size dummy variables, which take the value of one in each case if the acquirer assets (US$) are in the top 50th, 25th, or 10th percentile of all firms, and zero otherwise. To capture weak governance, we create a dummy variable equal to one if the acquirer's country-level governance index is below the median value across all countries. The model specification is as follows.

$$\begin{aligned} CAR_j = {} & \alpha + \beta^{(1)}\text{Large Acquirer Dummy}_j + \beta^{(2)}\text{Weak Gov Dummy}_j \\ & + \beta^{(3)}\left(\text{Large Acquirer Dummy}_j \times \text{Weak Gov Dummy}_j\right) + \boldsymbol{\theta X}_j + \lambda_t + \varepsilon_j \end{aligned} \tag{2}$$

where the variables are defined as above, with the exception that the model focuses on dummy variables. Here, we expect that $\beta^{(3)}$ will be positive, implying that larger acquirers in weak governance countries generally do better deals. We estimate the models in Eqs. (1) and (2) by using OLS regressions that include year dummies and cluster standard errors by four-digit SIC industry (following Petersen, 2009).

Table 5 reports OLS regressions based on Eqs. (1) (columns 1–4) and (2) (columns 5–8). Columns 1 and 2 show no significant relationship between CARs and firm size. This is not surprising given that Table 3 shows significant variations in acquirer returns across size/governance portfolios, suggesting that sovereign-heterogeneity might influence the size/CARs relationship. Columns 3 and 4 include the interaction terms 'ln(Assets) × WB Gov.' and 'ln(Assets) × ICRG Political Index'. The negative and significant coefficients on the interaction terms indicate that sovereign governance negatively moderates the impact of corporate size on takeover returns. When combined with the positive coefficient on ln(Assets), this suggests that while large size can convey some benefits in weak governance markets (in the form of connections and market power) these traits are less useful in stronger governance markets. We obtain similar results in columns 5–8, which contain dummy-variable regressions as in Eq. (2). The interaction term, which now captures the returns to large acquirers in weak governance countries, is positive and statistically significant for all definitions of 'large' (i.e., top 25th, 10th percentiles), confirming that large acquirer takeovers in weak governance are, on average, value creating. Thus, in stronger governance markets, firm size can induce agency conflicts of managerial entrenchment, which mitigate any benefits the firm might otherwise gain from its size.

The other control variables representing acquirer and deal characteristics generally have signs consistent with the literature. Relative size is positive and significant indicating that scale increases returns to the average deal, which is, on average, value-enhancing for acquirer shareholders, as reported in Table 2. Acquirers with higher leverage earn lower returns, consistent with higher financial risk. Tender offers, which may capture deal hostility, generate higher returns consistent with the disciplinary motive for takeovers (Jensen, 1986; Jensen and Ruback, 1983; Scharfstein, 1988). Stock swap deals generate lower returns, which is consistent with overvaluation and information asymmetry motives as reported in prior studies (Travlos, 1987). Targeting both public and private targets appears to reduce returns relative to subsidiary targets, however, the larger negative coefficient on public is consistent with larger losses in targeting publicly listed targets (Chang, 1998; Fuller et al., 2002). Substituting the public dummy variable for a subsidiary dummy (untabulated) confirms that both private and subsidiary deals earn significantly greater returns than public. The coefficient on the private dummy variable is marginally smaller, confirming that subsidiary deals earn the highest returns. The positive coefficient on ROA is consistent with the idea that higher quality managers tend to induce higher ROA, and higher quality managers may select more appropriate targets (Shleifer and Vishny, 1989).

The results provide some initial support for our first hypothesis, that larger acquirer takeovers in weak governance countries create greater value for acquirer shareholders.

4.2. Takeover approval and completion times (Hypothesis 2)

The next set of models examine whether larger firms in weak governance markets complete deals more quickly. We use a similar regression specification to Eqs. (1) and (2) above. Hypothesis 2 examines whether larger firms in weak governance markets complete deals more quickly. We measure the time to completion (the dependent variable) as the time between the announcement of the deal and the completion of the deal. Table 6 reports OLS regressions that examine the impact of acquirer size and country governance on deal completion times. The results are also robust if we use a tobit specification instead of OLS (untabulated). Columns 1 and 2 use continuous size and governance variables. Columns 3–6 use size and governance dummy variables. The results in columns 1 and 2 indicate that in stronger governance countries, larger companies take longer to complete deals than their smaller counterparts, suggesting that large companies face greater regulatory barriers in stronger governance

Table 6
Takeover approval (deal completion) regressions. The table reports OLS regressions that examine the length of time to deal completion. The dependent variable is the number of days to deal completion, measured from the deal announcement date to the completion date. Detailed variable definitions are reported in Appendix 1. The models include year dummies (untabulated). *P*-values calculated using heteroskedasticity-consistent standard errors and corrected for industry-level clustering (using 4-digit SIC industry codes) are reported in parentheses. Superscripts ***, **, and *, denote significance at 1%, 5%, and 10%, respectively.

Dependent variable	Days to completion					
	[1]	[2]	[3]	[4]	[5]	[6]
Ln(Assets)	0.604	1.257**				
	[0.348]	[0.045]				
WB Gov. Index	−206.427***					
	[0.000]					
Ln(Assets) * WB Gov. Index	4.711***					
	[0.000]					
ICRG Political Index		−282.221***				
		[0.000]				
Ln(Assets) * ICRG Political Index		4.495***				
		[0.000]				
Size top 25%			20.977***	23.958***		
			[0.000]	[0.000]		
Size top 10%					36.043***	37.380***
					[0.000]	[0.000]
Weak WB Gov. × Size top 25%			0.287			
			[0.917]			
Weak Political Gov. × Size top 25%				−4.859		
				[0.163]		
Weak WB Gov. × Size top 10%					−11.414**	
					[0.037]	
Weak Political Gov. × Size top 10%						−14.377***
						[0.009]
Weak WB Gov.			12.319***		13.180***	
			[0.000]		[0.000]	
Weak Political Gov.				18.747***		19.013***
				[0.000]		[0.000]
Tobin's q	0.975**	1.359***	0.727	1.045**	0.756	1.063**
	[0.024]	[0.004]	[0.127]	[0.027]	[0.113]	[0.025]
Relative size	33.679***	33.160***	31.742***	31.909***	31.086***	31.225***
	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]
Return on assets	−8.506*	−7.059	1.436	0.26	2.37	1.216
	[0.065]	[0.111]	[0.734]	[0.951]	[0.570]	[0.772]
Leverage	−14.662*	−10.793	−5.582	−5.642	−1.035	−0.985
	[0.051]	[0.152]	[0.505]	[0.477]	[0.903]	[0.904]
Cash-holdings	−8.723*	−9.535*	−3.856	−4.353	−5.657	−6.064
	[0.075]	[0.058]	[0.434]	[0.378]	[0.258]	[0.226]
CAPEX	−7.16	−8.419	−7.982	−10.871	−7.004	−10.22
	[0.505]	[0.442]	[0.452]	[0.336]	[0.503]	[0.356]
Diversifying	−5.797**	−6.252**	−5.712**	−6.159**	−5.579**	−6.057**
	[0.025]	[0.018]	[0.033]	[0.023]	[0.037]	[0.025]
Competed	39.355***	41.500***	41.307***	41.265***	40.846***	40.647***
	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]
Tender	−31.320***	−31.080***	−34.657***	−34.809***	−34.966***	−34.742***
	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]
Friendly	−28.992***	−31.494***	−37.088***	−35.818***	−37.494***	−36.188***
	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]
Cross-border	−2.411	−3.381**	−4.702***	−4.501***	−4.284***	−4.026***
	[0.117]	[0.033]	[0.003]	[0.005]	[0.004]	[0.009]
Cash only	−4.602***	−4.415***	−4.033***	−4.020***	−3.559**	−3.557**
	[0.001]	[0.002]	[0.006]	[0.007]	[0.012]	[0.012]
Stock only	22.895***	23.501***	26.587***	26.024***	26.923***	26.321***
	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]
Public target	52.371***	51.926***	50.937***	51.296***	51.036***	51.300***
	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]
Private target	−19.298***	−19.350***	−21.276***	−20.774***	−21.777***	−21.228***
	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]
Home market capitalization	1000.532***	1154.772***	371.691*	631.871***	346.691	617.369***
	[0.000]	[0.000]	[0.099]	[0.006]	[0.120]	[0.006]
Home turnover	−9.869***	−16.478***	−13.032***	−15.216***	−12.888***	−14.974***
	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]
FDI	−13.463	−28.957**	−38.708***	−48.655***	−37.900***	−47.633***
	[0.243]	[0.022]	[0.004]	[0.002]	[0.003]	[0.001]

(continued on next page)

Table 6 (*continued*)

Dependent variable	Days to completion					
	[1]	[2]	[3]	[4]	[5]	[6]
Unemployment	−2.983***	−3.918***	−2.757***	−3.126***	−2.746***	−3.127***
	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]
Trade imbalance	−64.806***	−70.996***	−98.346***	−106.042***	−90.903***	−100.325***
	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]
Constant	217.304***	277.701***	102.791***	101.682***	103.717***	102.763***
	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]
Observations	17,646	17,458	17,646	17,646	17,646	17,646
Adjusted R^2	25.30%	24.90%	23.10%	23.60%	23.10%	23.70%

countries. Conversely, the coefficients on the interaction terms (i.e. 'Weak WB Gov. × Size Top 10%' and 'Weak Political Gov. × Size Top 10%') in columns 3–6 highlight that in weak governance markets, larger companies take significantly less time to complete deals.[4] The statistically stronger results for the largest firms in our sample are consistent with our hypothesis that political connections will be concentrated in the largest firms.

4.3. Deal mood (Hypothesis 3)

Another mechanism whereby political connections can manifest in the takeover process is in the mood of the takeover. Hypothesis 3 predicts that stronger political connections may facilitate more friendly deals, which are likely to be less expensive for the acquirer. For these regression models, the dependent variable is a dummy indicator that equals one if the deal is 'friendly' in nature (i.e., target management recommend bid acceptance) and equals zero otherwise. The models are estimated using logit regressions.

Table 7 examines this further by testing whether larger firms in weak governance countries are significantly more likely to undertake friendly deals. The results are consistent with expectations. The interaction term in columns 1 and 2 indicates that large firms in stronger governance countries are less likely to do friendly deals. Conversely, the interaction term in columns 3–6 indicates that larger acquirers in weak governance countries are significantly more likely to do friendly deals than are larger acquirers in strong governance countries (or smaller acquirers in weak governance countries). We interpret this as evidence that political connections help facilitate friendly deals, which in part explain the larger returns earned by large acquirers in weak governance countries.

4.4. 'Expropriation' from the target's shareholders (Hypothesis 4)

Hypothesis 4 predicts that one avenue in which acquirers can create value for their own shareholders is by 'expropriating' wealth from the target's shareholders by paying a low acquisition premium. We test this by calculating the takeover premiums that firms pay in acquisitions of listed targets (we cannot obtain data for unlisted targets because there is no pre-acquisition market value for these targets). The dependent variable is measured as the transaction value scaled by the target's market value one week or four weeks before the takeover. This is a relatively standard way to compute takeover premiums (Alexandridis et al., 2013; Harford et al., 2012; Humphery-Jenner and Powell, 2011).

We report models that examine takeover premiums in Table 8. The negative and significant coefficient on the interaction terms suggests that larger acquiring firms in strong governance countries pay lower premiums, on average, than do smaller firms. The negative, but insignificant firm size coefficients indicate that premiums, on average, do not differ significantly between large and small acquirers in weak governance countries. This is opposite to our prediction for Hypothesis 4, and suggests that the size/governance effect does not merely reflect large acquirers in weak governance countries expropriating value from target firm shareholders. The inferences are unchanged when we use the size dummy variable specification as denoted by Eq. (2) (untabulated).

4.5. Government connections (Hypothesis 5)

This section examines in more detail the linkages between larger acquirers in weak governance countries and political connections.

First, we examine whether large acquirers in weak governance countries perform better than large acquirers in strong governance countries in the types of deals for which connections might be more important. Specifically, we explore whether the large firms' benefits accrue in domestic deals and diversifying deals (Table 9). We anticipate that larger firms' advantages will especially manifest in domestic deals because these deals are more likely to benefit from large firms' hypothesized political connections. Further, given that (a) government-mandated deals and government intervention can induce value-destroying

[4] While the coefficients on the governance variables are negative and large in magnitude, this does not imply that the deal takes a 'negative' period to complete; instead, the similarly large constant term and the presence of interaction variables, suggests that deals have a positive time-to-completion.

Table 7
Deal mood regressions. The table reports logit regressions that examine the mood of the takeover. The dependent variable is equal to 1 if the deal is friendly, and 0 otherwise. Detailed variable definitions are reported in Appendix 1. The models include year dummies (untabulated). *P*-values calculated using heteroskedasticity-consistent standard errors and corrected for industry-level clustering (using 4-digit SIC industry codes) are reported in parentheses. Superscripts ***, **, and *, denote significance at 1%, 5%, and 10%.

Dependent variable	Friendly deal indicator					
	[1]	[2]	[3]	[4]	[5]	[6]
Ln(Assets)	0.094**	0.076*				
	[0.023]	[0.066]				
WB Gov. Index	5.871***					
	[0.000]					
Ln(Assets) * WB Gov. Index	−0.156***					
	[0.001]					
ICRG Political Index		8.868***				
		[0.000]				
Ln(Assets) * ICRG Political Index		−0.127***				
		[0.009]				
Size top 25%			−1.575***	−1.446***		
			[0.000]	[0.000]		
Size top 10%					−1.001***	−1.203***
					[0.001]	[0.000]
Weak WB Gov. × Size top 25%			1.406***			
			[0.000]			
Weak Political Gov. × Size top 25%				1.338***		
				[0.000]		
Weak WB Gov. × Size top 10%					0.618*	
					[0.097]	
Weak Political Gov. × Size top 10%						1.046***
						[0.004]
Weak WB Gov.			−1.348***		−0.894***	
			[0.000]		[0.000]	
Weak Political Gov.				−1.102***		−0.793***
				[0.000]		[0.000]
Tobin's q	0.049	0.033	0.027	0.028	0.029	0.029
	[0.277]	[0.467]	[0.556]	[0.544]	[0.523]	[0.516]
Relative size	−0.373***	−0.342***	−0.348***	−0.354***	−0.331***	−0.331***
	[0.001]	[0.002]	[0.001]	[0.001]	[0.001]	[0.001]
Return on assets	0.371	0.239	0.194	0.208	0.058	0.09
	[0.365]	[0.559]	[0.628]	[0.602]	[0.882]	[0.819]
Leverage	0.166	0.052	0.051	0.114	−0.113	−0.083
	[0.706]	[0.904]	[0.909]	[0.799]	[0.797]	[0.850]
Cash-holdings	−0.790*	−0.728*	−0.932**	−0.865*	−0.735*	−0.695
	[0.065]	[0.092]	[0.038]	[0.051]	[0.097]	[0.113]
CAPEX	1.501*	1.392*	0.986	1.296	1.117	1.368*
	[0.074]	[0.083]	[0.229]	[0.109]	[0.170]	[0.092]
Diversifying	−0.049	−0.017	−0.035	−0.02	−0.058	−0.043
	[0.707]	[0.891]	[0.780]	[0.874]	[0.648]	[0.738]
Tender offer	−1.606***	−1.574***	−1.562***	−1.528***	−1.561***	−1.540***
	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]
Cross-border	0.033	0.025	0.107	0.128	0.078	0.092
	[0.826]	[0.862]	[0.466]	[0.390]	[0.597]	[0.543]
Cash only	−0.118	−0.134	−0.08	−0.11	−0.099	−0.126
	[0.460]	[0.400]	[0.598]	[0.479]	[0.518]	[0.420]
Stock only	0.165	0.166	0.146	0.142	0.152	0.137
	[0.454]	[0.457]	[0.516]	[0.535]	[0.495]	[0.545]
Public target	−1.009***	−1.049***	−0.957***	−0.927***	−1.005***	−0.967***
	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]
Private target	−0.804***	−0.777***	−0.740***	−0.752***	−0.701***	−0.710***
	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]
Home market capitalization	−45.749***	−38.277***	−24.937***	−26.742***	−25.927***	−27.109***
	[0.000]	[0.000]	[0.005]	[0.003]	[0.004]	[0.003]
Home turnover	0.228	0.384*	0.638***	0.619***	0.592***	0.599***
	[0.279]	[0.069]	[0.004]	[0.004]	[0.009]	[0.006]
FDI	−0.954**	−0.938**	−0.621	−0.6	−0.746	−0.73
	[0.028]	[0.031]	[0.133]	[0.140]	[0.130]	[0.154]
Unemployment	0.145***	0.187***	0.165***	0.174***	0.167***	0.171***
	[0.003]	[0.000]	[0.002]	[0.003]	[0.003]	[0.003]
Trade imbalance	5.317***	6.168***	6.164***	5.893***	6.354***	5.954***
	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]

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Table 7 (*continued*)

Dependent variable	Friendly deal indicator					
	[1]	[2]	[3]	[4]	[5]	[6]
Constant	0.772	−2.123	6.230***	5.870***	5.807***	5.588***
	[0.467]	[0.104]	[0.000]	[0.000]	[0.000]	[0.000]
Observations	17,647	17,459	17,647	17,647	17,647	17,647
Pseudo R^2	18.27%	17.69%	18.40%	17.99%	17.28%	17.15%

diversification (Fan et al., 2008), and (b) we expect large firms to be more able to resist such government-directed deals, we anticipate that large firms in weak governance markets will do better in diversifying deals than will small firms. The models in Table 9 estimate the CARs regressions (Eqs. (1) and (2)) for sub-samples of domestic deals and diversifying deals. The results are largely consistent with expectations. Panel A uses continuous size and governance variables and Panels B–C use size and governance dummy variables. The results indicate that large firms perform better (worse) in weak (strong) governance markets in domestic deals and in diversifying deals. This implies that large firms are more able to use their connections to both pursue domestic deals and resist value-destroying diversification.

The second set of models uses the country-level measures of the importance of connections. We expect that larger firms will perform better in countries where political connections are more important. We use the data on aggregate country-level political connections from Faccio (2006) to examine the importance of corporate size in countries where political connections appear to be especially important. Faccio (2006) collects data on corporate political connections in 47 countries. The data pertains to the period of 1997 to 2001. Faccio (2006) provides aggregate country-level data on the percentage of firms who have a member of parliament, head of state, or close relative thereof as a top officer. We use these country-level variables to analyze the importance of size in countries where connections appear to be especially prominent and important. We focus on country-level variables because (a) they allow us to get an overall picture of the importance of connections in the acquirer's country, (b) they allow us to retain our full time-period (as opposed to just looking at the point in time underlying the Faccio (2006) dataset), and (c) they obviate concerns over endogeneity between the firm's specific level of connections and its size. This dataset has received significant use in the literature (Faccio, 2006, 2010). We exclude from the sample firms that are listed in the United Kingdom because the UK presents a significant outlier in the Faccio (2006) dataset. Specifically, Faccio (2006) reports that 46% of the top 50 UK firms have political connections. It is not economically sensible that nepotism-through-connections would be so widespread in a country that otherwise scores highly in all metrics of sovereign governance. We estimate the following model.

$$\begin{aligned} \text{CAR}_j = {} & \alpha + \beta^{(1)} \ln(\text{Assets})_j + \beta^{(2)} \text{Sovereign Connection Rate}_j \\ & + \beta^{(3)} \left(\ln(\text{Assets})_j \times \text{Sovereign Connection Rate}_j \right) + \boldsymbol{\theta X}_j + \lambda_t + \varepsilon_j \end{aligned} \tag{3}$$

where, Sovereign Connection Rate$_j$ denotes one of the three key measures of the average level of political connections in the acquirer's country. The measures are the percentage of all firms in the acquirer's country who have as one of their top officers or large shareholders either (a) a member of parliament or head of state, or is (b) closely related to a member of parliament or head of state. We also examine the percentage of the top 50 firms in the country who have as a top officer a member of parliament/head of state or a close relative of such.

We report these models in Table 10. As indicated above, we exclude acquirers in the United Kingdom from the sample given that they represent an outlier in the Faccio (2006) dataset. The main finding is that the coefficient on the interaction term is significant and positive, suggesting that the benefits of corporate size increase with the importance of political connections in a country.

4.6. Operating performance (Hypothesis 6)

We expect that large firms in weak governance markets will do takeovers that yield greater improvements in operating performance (Hypothesis 6). We capture this by creating indicators for whether the acquirer's EBIT/Assets 1, 2, or 3 years after the takeover exceeds its EBIT/Assets 1-year before the takeover announcement (for three variables in total). We estimate these models using logit regressions.

The results reported in Table 11 indicate that in weak governance markets, large firms' acquisitions are more likely to increase operating performance. The coefficient on 'ln(Assets)' is positive and statistically insignificant, implying that firm size does not per-se significantly increase the likelihood of operating performance improvements. The coefficients on the governance variables, 'WB Gov Index' and 'ICRG Political Index' are positive (in all but one case) and sometimes statistically significant, suggesting that takeovers, on average, tend to perform better when they are conducted by acquirers in a strong-governance market. The negative, and statistically significant coefficient on the interaction terms implies that large firms perform comparatively worse in strong governance markets than they do in weak governance markets.

4.7. Additional robustness tests

In this section we report the findings of some additional tests that further test the robustness of our findings to alternative firm size definitions, and to other sources of heterogeneity that might explain why larger firms perform better (worse) in weak

Table 8
Takeover premium regressions. The table reports OLS regressions that examine the determinants of takeover premiums. The dependent variable is the target's takeover premium, calculated as [Transaction value / Target Market Value (t) − 1] where we calculate the target's market value one week or four weeks before the acquisition (as denoted in the column headers). The key independent variables are Ln(Assets), the Governance Variables, and the interaction term 'Ln(Assets) × Governance.' The governance variables are the World Bank (WB) governance variables (columns 1 and 4), the ICRG composite index (columns 2 and 5), and the ICRG political index (columns 3 and 6). For all governance variables, a higher value indicates better governance. Detailed variable definitions are reported in Appendix 1. The models include year dummies (untabulated). *P*-values calculated using heteroskedasticity-consistent standard errors and corrected for industry-level clustering (using 4-digit SIC industry codes) are reported in parentheses. Superscripts ***, **, and *, denote significance at 1%, 5%, and 10%, respectively.

Dependent variable	Premium (1 week)			Premium (4 weeks)		
	[1]	[2]	[3]	[4]	[5]	[6]
Ln(Assets)	−0.356	−0.091	−0.219	−1.305	−1.008	−1.187
	[0.747]	[0.931]	[0.843]	[0.246]	[0.352]	[0.285]
WB Gov. Index	9.511			−5.907		
	[0.627]			[0.765]		
Ln(Assets) * WB Gov. Index	−1.481**			−1.405**		
	[0.018]			[0.041]		
ICRG Composite Index		10.333			−27.342	
		[0.824]			[0.575]	
Ln(Assets) * ICRG Composite Index		−1.547**			−1.376*	
		[0.024]			[0.070]	
ICRG Political Index			8.319			−12.278
			[0.789]			[0.702]
Ln(Assets) * ICRG Political Index			−1.488**			−1.309*
			[0.024]			[0.076]
Tobin's q	0.283	0.258	0.266	1.348**	1.346**	1.373**
	[0.526]	[0.569]	[0.559]	[0.017]	[0.018]	[0.015]
Relative size	−4.089**	−4.185**	−4.189**	−4.141	−4.262*	−4.17
	[0.040]	[0.035]	[0.037]	[0.102]	[0.091]	[0.101]
Return on assets	−10.499	−11.045	−10.987	−2.097	−2.595	−2.554
	[0.324]	[0.306]	[0.309]	[0.839]	[0.803]	[0.807]
Leverage	3.926	4.899	4.895	6.982	7.569	7.478
	[0.594]	[0.515]	[0.514]	[0.399]	[0.369]	[0.374]
Cash-holdings	16.098**	15.935**	15.855**	13.272*	13.133*	12.985*
	[0.019]	[0.026]	[0.026]	[0.075]	[0.084]	[0.088]
CAPEX	−14.563	−14.727	−14.582	−34.163**	−33.601**	−33.608**
	[0.381]	[0.383]	[0.384]	[0.026]	[0.030]	[0.029]
Diversifying	1.32	1.303	1.31	0.509	0.329	0.353
	[0.519]	[0.536]	[0.533]	[0.833]	[0.893]	[0.885]
Competed	16.715***	17.212***	17.255***	18.328***	18.748***	18.844***
	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]
Tender	2.059	2.211	2.241	2.093	2.2	2.311
	[0.260]	[0.246]	[0.243]	[0.310]	[0.297]	[0.276]
Friendly	−8.942**	−8.107**	−8.204**	−3.219	−2.301	−2.423
	[0.023]	[0.040]	[0.038]	[0.431]	[0.574]	[0.556]
Cross-border	6.357***	6.539***	6.544***	8.508***	8.285***	8.398***
	[0.008]	[0.006]	[0.007]	[0.001]	[0.001]	[0.001]
Cash only	8.336***	8.267***	8.243***	9.658***	9.610***	9.594***
	[0.000]	[0.001]	[0.001]	[0.000]	[0.000]	[0.000]
Stock only	−1.799	−1.599	−1.642	0.832	0.95	0.899
	[0.466]	[0.525]	[0.513]	[0.753]	[0.721]	[0.735]
Home market capitalization	466.193	451.195	459.146	587.335*	611.757*	594.154*
	[0.142]	[0.177]	[0.163]	[0.085]	[0.092]	[0.090]
Home turnover	0.233	−0.193	−0.313	4.57	4.366	3.859
	[0.943]	[0.955]	[0.928]	[0.249]	[0.298]	[0.358]
FDI	8.462	8.563	8.484	3.216	3.514	3.363
	[0.652]	[0.648]	[0.649]	[0.853]	[0.841]	[0.846]
Unemployment	−0.37	−0.354	−0.4	−0.661	−0.729	−0.713
	[0.414]	[0.505]	[0.417]	[0.125]	[0.161]	[0.146]
Trade imbalance	19.07	19.668	21.264	−1.232	−10.115	1.426
	[0.204]	[0.362]	[0.167]	[0.944]	[0.686]	[0.937]
Constant	55.156*	49.354	53.254	81.970***	92.112**	83.014**
	[0.060]	[0.250]	[0.154]	[0.006]	[0.040]	[0.035]
Observations	1889	1865	1865	1895	1871	1871
Adjusted R^2	9.40%	9.40%	9.40%	10.10%	10.00%	10.00%

(strong) governed countries. Due to the large number of additional tests conducted, we do not tabulate them for reporting convenience. They are, however available from the authors on request.

4.7.1. Measuring firm size

We measure firm size as a continuous variable, and by using size dummy variables. Both measures do not take into account relative size differences across countries. Nevertheless, we repeat our analysis using size measures that capture the relative size within each country. Specifically, for each country, we define large dummy variables by allocating acquiring firms to the top 25th and 10th percentiles in assets of local currency. Our results remain unchanged.

4.7.2. Firm-level governance

Firm-level governance quality could be argued as a potential source of heterogeneity between firms that may not be captured by our country-level governance variables. Given the scant availability of corporate governance measures (e.g., board and ownership data, shareholder rights indices) for most of the countries in our sample, we develop a proxy measured as the absolute level of discretionary accruals. The level of discretionary accruals is argued to reflect the quality of earnings and the earnings management (Dechow and Dichev, 2002; Dechow et al., 1995; Jones, 1991). The idea here is that earnings management is more likely to occur in weakly governed firms, possibly due to weak oversight by the board, and/or weak internal control and audit

Table 9
Domestic and diversifying deals (CARs). The table reports OLS regressions that examine the market's reaction to the firm's takeover decision for sub-samples of domestic deals and diversifying deals. The panel header states the size-variable under analysis. The dependent variable is the 11-day market-adjusted CAR. The models contain all control variables as in Table 5, which are suppressed for brevity. Detailed variable definitions are reported in Appendix 1. The models include year dummies (untabulated). *P*-values calculated using heteroskedasticity-consistent standard errors and corrected for industry-level clustering (using 4-digit SIC industry codes) are reported in parentheses. Superscripts ***, **, and *, denote significance at 1%, 5%, and 10%, respectively.

Sample	Domestic		Diversifying	
	[1]	[2]	[3]	[4]
Panel A: Continuous size variable				
Ln(Assets)	0.224***	0.209**	0.290***	0.303***
	[0.007]	[0.012]	[0.003]	[0.001]
WB Gov. Index	4.894***		5.353***	
	[0.005]		[0.004]	
Ln(Assets) * WB Gov. Index	−0.419***		−0.406***	
	[0.000]		[0.000]	
ICRG Political Index		3.16		5.387**
		[0.221]		[0.027]
Ln(Assets) * ICRG Political		−0.423***		−0.429***
Index		[0.000]		[0.000]
Controls	Yes	Yes	Yes	Yes
Observations	13,085	13,023	11,853	11,727
Adjusted R^2	3.90%	3.90%	3.10%	3.10%
Panel B: Size top 10%				
Size top 10%	−1.433***	−1.203***	−1.400***	−1.323***
	[0.000]	[0.000]	[0.001]	[0.001]
Bad WB Gov.	−0.38		−0.352	
	[0.152]		[0.134]	
Bad WB Gov. × Size top 10%	0.921**		0.678	
	[0.013]		[0.145]	
Bad Political Gov.		0.119		0.023
		[0.575]		[0.904]
Bad Political Gov. × Size		0.642*		0.609
top 10%		[0.072]		[0.177]
Controls	Yes	Yes	Yes	Yes
Observations	13,085	13,085	11,853	11,853
R-squared	3.60%	3.60%	2.80%	2.80%
Panel C: Size top 25%				
Size top 25%	−1.490***	−1.359***	−1.295***	−1.236***
	[0.000]	[0.000]	[0.000]	[0.000]
Bad WB Gov.	−0.467*		−0.449*	
	[0.086]		[0.085]	
Bad WB Gov. × Size top 25%	0.856***		0.677**	
	[0.004]		[0.047]	
Bad Political Gov.		0.037		−0.059
		[0.869]		[0.783]
Bad Political Gov. × Size		0.686***		0.611**
top 25%		[0.005]		[0.040]
Controls	Yes	Yes	Yes	Yes
Observations	13,085	13,085	11,853	11,853
R-squared	3.80%	3.90%	2.90%	2.80%

systems (Beasley, 1996; Becker et al., 1998; Chtourou et al., 2001). We measure discretionary accruals using the modified Jones (1991) approach. We do not use accruals-variables in the reported models because even requiring data on discretionary accruals significantly reduces the sample size (to 11,349 observations). Including the absolute value of discretionary accruals to total accruals in our models does not alter our conclusions.

4.7.3. Target country governance

We also examine whether the sovereign governance in the target's country influences acquirer takeover returns. Target-country governance is incrementally relevant only if the deal is cross-border (for a domestic takeover, the target and acquirer have the same governance). Thus, we constrain our sample to include only these takeovers. The results indicate that target country governance has no significant impact on acquirer profitability.

4.7.4. Country-effects

The results are not driven by observations deriving from any one country. The results are robust to omitting observations from the USA (which account for a large portion of the sample). We also find similar results to Moeller et al. (2004) if we restrict the sample to contain only companies from the USA. Further, we also employ a weighted least squares (WLS) specification that down-weights acquisitions made by acquirers in countries that feature many observations (specifically, weighting each observation by the inverse of the proportion of deals (in dollar terms) that come from the acquirer's country). The WLS approach is probably preferable to simply omitting observations from particular countries. For example, if we omit the USA, then the UK, Australia and Canada comprise two-thirds of the remaining sample. The results for the WLS models are consistent with the reported regression results. The results are also qualitatively robust to including acquirer and/or target country-fixed effects.

4.7.5. Alternative governance and omitted variables

The results are robust to using different measures of sovereign governance. We focus on the variables that are most associated with political risk and that have the potential to vary over time as countries develop. Nonetheless, the results are qualitatively similar if we use measures such as the anti-director rights index (as per La Porta et al., 1997), or the anti-self-dealing index (as per Djankov et al., 2008). Further, the results are robust to whether we use the original index or the updated version from Spamann (2010). The robustness across governance variables likely reflects the high degree of correlation amongst measures of sovereign governance.

We also examine whether omitted variable bias poses a problem for our models. One variable that is absent from our models is a direct measure of market power. While our models include industry dummies, which should capture some of the effects of greater market power, we nevertheless re-estimate the models including the Herfindahl–Hirschman Index (HHI), and find that our findings remain largely unchanged. The HHI term is positively related to acquirer CARs, consistent with the idea that market-power-motivated acquisitions can improve acquirer-value.

The results are also robust to controlling for the amount of M&A activity in the acquirer's country. We do this to control for the likelihood that the market for corporate control is less competitive in weak governance countries. We find that while the level of M&A activity is negatively related to acquirer CARs, the results are qualitatively the same as those reported in the paper.

4.7.6. Government ownership and sovereign wealth fund involvement

One concern is that the results might merely reflect government owned institutions making connected deals. However, only 91 acquirers have government or sovereign wealth fund ownership, and the results are qualitatively similarly if we omit these 91 deals.

4.7.7. Relative deal size

Alexandridis et al. (2013) argue that the deal size (relative to that of the acquirer) can significantly influence acquirer returns and can at least partially explain the size effect in acquisitions. We mitigate this concern by controlling for relative deal size in the reported results. In addition, in untabulated robustness tests, we split the sample into the top 50% and bottom 50% in terms of relative deal size. We find similar results to the reported results in both the high relative-deal-size and low relative-deal-size subsamples, suggesting that relative-deal-size does not drive our results.

5. Conclusion

This study examines the relationship between the acquirer size effect and sovereign governance. Prior literature from developed markets has generally focused on firm size as a source of agency conflicts and value destruction. However, large size could provide some off-setting benefits in weak governance environments. These benefits might derive from political connections and market power. They might also derive from larger size offering some protection from regimes that are affected by corruption at the government level.

We show that in weak governance markets, large firms' acquisitions earn significantly higher announcement returns, and are more likely to increase operating performance than they are in strong governance markets. We provide some evidence on the sources of these gains, including some evidence that larger firms in weak governance markets (compared with those in strong governance countries) tend to complete deals faster and tend to be more likely to do friendly deals. We also find evidence suggesting that at least part of the benefits of large size result from political connections. We take steps to ensure that the results are robust to potential alternative explanations and model specification issues.

Table 10
Examining the importance of connections. The table reports OLS regressions that examine the importance of corporate size in countries where political connections are particularly important. The dependent variable is the 11-day market-adjusted CAR. The key independent variables are Ln(Assets). Detailed variable definitions are reported in Appendix 1. The models include year dummies (untabulated). *P*-values calculated using heteroskedasticity-consistent standard errors and corrected for industry-level clustering (using 4-digit SIC industry codes) are reported in parentheses. Superscripts ***, **, and *, denote significance at 1%, 5%, and 10%, respectively.

	[1]	[2]	[3]
Ln(Assets)	0.035	−0.032	−0.026
	[0.622]	[0.687]	[0.762]
% Firms with MP/HOS or relative thereof	−1.575***		
	[0.002]		
Ln(Assets) * % Firms with MP/HOS or relative thereof	0.080***		
	[0.002]		
% Firms with MP/HOS		−3.352***	
		[0.001]	
Ln(Assets) * % Firms with MP/HOS		0.167***	
		[0.002]	
% Top 50 Firms with MP/HOS or relative thereof			−0.961***
			[0.000]
Ln(Assets) * % Top 50 Firms with MP/HOS or relative thereof			0.049***
			[0.001]
Tobin's q	0.275***	0.273***	0.271***
	[0.000]	[0.000]	[0.000]
Relative size	1.452***	1.447***	1.441***
	[0.000]	[0.000]	[0.000]
Return on assets	0.311	0.328	0.261
	[0.646]	[0.630]	[0.696]
Leverage	−1.405**	−1.442**	−1.381**
	[0.041]	[0.035]	[0.044]
Cash-holdings	−1.055**	−1.044**	−1.036**
	[0.038]	[0.039]	[0.040]
CAPEX	−4.604***	−4.506***	−4.752***
	[0.000]	[0.000]	[0.000]
Diversifying	0.007	0.001	0.008
	[0.975]	[0.995]	[0.971]
Competed	−0.074	−0.079	−0.089
	[0.918]	[0.912]	[0.901]
Tender	1.124**	1.131**	1.066*
	[0.049]	[0.047]	[0.065]
Friendly	−1.186**	−1.157**	−1.216**
	[0.029]	[0.032]	[0.027]
Cross-border	−0.433*	−0.387*	−0.478**
	[0.062]	[0.088]	[0.043]
Cash only	−0.243	−0.259	−0.208
	[0.218]	[0.186]	[0.290]
Stock only	−0.715***	−0.726***	−0.689***
	[0.003]	[0.002]	[0.003]
Public target	−3.440***	−3.425***	−3.448***
	[0.000]	[0.000]	[0.000]
Private target	−0.432***	−0.428***	−0.441***
	[0.004]	[0.004]	[0.003]
Home market capitalization	−1.656	−7.681	2.464
	[0.940]	[0.731]	[0.910]
Home turnover	−0.071	−0.11	0.184
	[0.831]	[0.738]	[0.555]
FDI	−0.629	0.416	−1.058
	[0.771]	[0.847]	[0.634]
Unemployment	−0.025	−0.014	−0.038
	[0.572]	[0.761]	[0.406]
Trade imbalance	−1.537	−2.053	−0.352
	[0.251]	[0.121]	[0.789]
Constant	2.777	4.010**	4.133**
	[0.105]	[0.028]	[0.039]
Observations	14,340	14,340	14,340
Adjusted R^2	3.40%	3.40%	3.50%

The results also help to explain why large acquirers earn lower takeover returns in strong governance environments, where size may give rise to potential entrenchment problems and agency conflicts. In these environments, regulatory strength effaces the political and protective benefit of being a large firm. This means that large size is relatively less useful as a protective mechanism in these markets. Thus, large size begins to reduce shareholder wealth due to possible agency and other conflicts.

Table 11
Examining post-takeover operating performance. This table contains regressions that examine post-takeover improvements in operating performance. The dependent variable is an indicator that equals one if the acquirer's EBIT/Assets one year (columns 1–2), two years (columns 3–4), or three years (columns 5–6) after the acquisition exceeds its EBIT/Assets one year before the acquisitions. Detailed variable definitions are reported in Appendix 1. The models include year dummies (untabulated). P-values calculated using heteroskedasticity-consistent standard errors and corrected for industry-level clustering (using 4-digit SIC industry codes) are reported in parentheses. Superscripts ***, **, and *, denote significance at 1%, 5%, and 10%, respectively.

Dependent variable	One year increase		Two year increase		Three year increase	
	[1]	[2]	[3]	[4]	[5]	[6]
Ln(Assets)	0.005	0.014	0.009	0.013	0.03	0.026
	[0.781]	[0.426]	[0.556]	[0.405]	[0.129]	[0.160]
WB Gov. Index	1.025***		0.391		0.165	
	[0.007]		[0.283]		[0.703]	
Ln(Assets) * WB Gov. Index	−0.087***		−0.049***		−0.050***	
	[0.000]		[0.000]		[0.004]	
ICRG Political Index		1.874***		0.443		−0.835
		[0.001]		[0.394]		[0.109]
Ln(Assets) * ICRG Political Index		−0.089***		−0.053***		−0.057***
		[0.000]		[0.000]		[0.002]
Tobin's q	0.011	0.011	0.043**	0.044**	0.014	0.015
	[0.635]	[0.632]	[0.029]	[0.026]	[0.441]	[0.408]
Relative size	0.049	0.054	0.058	0.057	0.155***	0.151***
	[0.337]	[0.295]	[0.254]	[0.271]	[0.001]	[0.001]
Return on assets	2.747***	2.738***	0.375***	0.376***	−0.219	−0.211
	[0.000]	[0.000]	[0.008]	[0.008]	[0.134]	[0.147]
Leverage	−0.355	−0.35	0.039	0.047	0.117	0.14
	[0.152]	[0.155]	[0.878]	[0.852]	[0.539]	[0.463]
Cash-holdings	0.904***	0.911***	0.292**	0.282**	0.541***	0.530***
	[0.000]	[0.000]	[0.030]	[0.037]	[0.000]	[0.000]
CAPEX	−0.123	−0.133	−0.436	−0.447	−0.064	−0.067
	[0.647]	[0.619]	[0.137]	[0.125]	[0.864]	[0.858]
Diversifying	0.101**	0.103**	−0.028	−0.03	−0.055	−0.062
	[0.030]	[0.027]	[0.609]	[0.586]	[0.375]	[0.320]
Competed	0.328	0.321	0.07	0.057	0.231	0.211
	[0.133]	[0.143]	[0.741]	[0.788]	[0.260]	[0.305]
Tender	0.077	0.057	−0.095	−0.119	−0.077	−0.078
	[0.476]	[0.607]	[0.328]	[0.226]	[0.465]	[0.452]
Friendly	−0.096	−0.105	−0.086	−0.083	−0.025	−0.028
	[0.508]	[0.471]	[0.571]	[0.579]	[0.880]	[0.868]
Cross-border	−0.104**	−0.110**	−0.126**	−0.126**	−0.155***	−0.152***
	[0.030]	[0.022]	[0.016]	[0.016]	[0.009]	[0.010]
Cash only	−0.081**	−0.079*	0.015	0.015	−0.095**	−0.095**
	[0.048]	[0.054]	[0.692]	[0.702]	[0.017]	[0.019]
Stock only	0.162***	0.166***	−0.01	−0.009	−0.136**	−0.136**
	[0.009]	[0.008]	[0.872]	[0.886]	[0.048]	[0.049]
Public target	−0.243***	−0.252***	−0.219***	−0.213***	−0.106	−0.094
	[0.000]	[0.000]	[0.002]	[0.002]	[0.154]	[0.200]
Private target	−0.087*	−0.091*	−0.088**	−0.091**	−0.079	−0.079
	[0.064]	[0.052]	[0.033]	[0.029]	[0.106]	[0.108]
Home market capitalization	−9.143	−10.819*	−7.031	−7.318	−5.559	−4.151
	[0.152]	[0.085]	[0.232]	[0.205]	[0.336]	[0.473]
Home turnover	0.111	0.101	0.068	0.05	0.056	0.031
	[0.133]	[0.159]	[0.337]	[0.473]	[0.445]	[0.664]
FDI	−0.234	−0.105	0.562	0.534	0.044	−0.139
	[0.762]	[0.894]	[0.422]	[0.454]	[0.946]	[0.835]
Unemployment	0.008	0.013	−0.007	−0.008	−0.029**	−0.038**
	[0.530]	[0.313]	[0.554]	[0.536]	[0.046]	[0.011]
Trade imbalance	−1.063***	−0.852**	−1.148***	−1.106***	−1.493***	−1.658***
	[0.008]	[0.037]	[0.002]	[0.002]	[0.000]	[0.000]
Constant	−0.354	−1.234*	−0.142	−0.202	−0.424	0.609
	[0.505]	[0.072]	[0.777]	[0.753]	[0.491]	[0.350]
Observations	15,049	15,001	15,048	15,000	15,047	14,999
Pseudo R-squared	4.96%	4.95%	3.45%	3.43%	3.48%	3.51%

The results also provide useful avenues for future research. Future studies could analyze other corporate and macroeconomic factors that moderate the size-effect in acquisitions. Additional research could also extend the analysis in Offenberg (2009) to examine the extent to which corporate size entrenches managers in weaker governance markets, potentially providing another explanation for the weaker-size effect documented in this study.

Appendix 1

Table A1
Variable definitions.

Variable	Definition
Bidder characteristics	
CARs	11-day cumulative abnormal returns (%), calculated using the market model, and the market-adjusted model. The paper estimates market model parameters over days (−210, −11) using an OLS model. We obtain the financial data from Datastream.
Firm size measures	Log of total assets; Log of market value (number of shares outstanding × price 11 days prior to announcement)
Leverage	Book value of debt scaled by total assets
Tobin's q	Market value of assets scaled by book value of assets. The market value of assets is the firm's market capitalization plus its book assets less its book equity.
CAPEX	The firm's capital expenditure (CAPEX) scaled by its sales
Return on assets	The return on assets is the firm's operating income scaled by its book assets.
Cash-holdings	The firm's cash holdings scaled by its book assets.
Deal characteristics	
Public target	Dummy: 1 for public targets, 0 otherwise
Private target	Dummy: 1 for private targets, 0 otherwise
Cash only	Dummy: 1 for deals financed with cash only, 0 otherwise
Stock only	Dummy: 1 for deals financed with stock only, 0 otherwise
Diversifying	Dummy: 1 where bidder and target are in a different Fama–French industry, 0 otherwise
Relative size	Transaction value over bidder's market capitalization 11 days before the announcement date.
Friendly	Dummy: 1 for deals recommended by target management, 0 otherwise
Competed	Dummy: 1 for competed deals, 0 otherwise
Tender offer	Dummy: 1 for tender offer deals, 0 otherwise
Cross-border	Dummy: 1 for cross-border deals
Approval (days to completion)	Number of days from the takeover announcement date to the takeover completion date
Takeover premium	Transaction value scaled by the target's market value 1 or 4 weeks prior to takeover announcement minus 1
Country governance-type characteristics	
% firms with MP/HOS or relative thereof	The percentage of firms in the country that have a member-of-parliament/politician or a head-of-state (or a relative thereof) on their board. The data is from Faccio (2006).
% firms with MP/HOS	The percentage of firms in the country that have a member-of-parliament/politician or a head-of-state on their board. The data is from Faccio (2006).
% top 50 firms with MP/HOS or relative thereof	The percentage of the top 50 firms in the country that have a member-of-parliament/politician or a head-of-state on their board. The data is from Faccio (2006).
ICRG Political Index	The ICRG political risk index. The original index goes from 0 to 20. We normalize the index to range from 0 to 1. A higher score indicates better governance.
WB Gov Index	The World Bank governance index is based on six World Bank governance sub-variables. The six World Bank variables are percentile ranks in terms of accountability, government effectiveness, political stability, regulation, the rule of law, and corruption. We compute a composite governance index (WB governance index), which is the equally weighted average of these six percentile ranks. The governance index ranges from 0 to 1 with a higher score representing better governance.
Country characteristics (sourced from the World Bank)	
Home market capitalization (%)	Market capitalization of listed companies/GDP
Home stock turnover (%)	Total value of shares traded/average market capitalization
FDI (%)	Net inflows of investment/GDP
Unemployment (%)	% of labor force without work
Trade imbalance	(imports − exports) / (imports + exports)

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