Track 4:
FDI in and from emerging market economies
Poster

THE COSTS OF LEGITIMACY

This poster seeks to reveal how companies use different legitimacy signals that lead to different evaluations by market participants when engaging in cross-border merger and acquisitions (cbM&A). The focus is on emerging market as well as on new developed market (EM/DM) firms when considering M&As in advanced markets (AM). Due to institutional differences, firms face pressures in the respective host countries. These constellations may lead to idiosyncrasies of the deal making process and subsequent deal evaluation depending on certain legitimacy signals used.

This poster's theoretical underpinnings stem from signaling theory (Spence, 1973; 1974), cheap talk (Bhattacharya & Dittmar, 2001; Brennan and Hughes, 1991; Crawford & Sobel, 1982) and institutional theory (e.g. DiMaggio & Powell, 1991; Hybels, 1995; Kostova, 1999; Xu & Shenkar, 2002). In the classic job market model of signaling theory, Spence (1973) showed how high-quality job applicants reduce the uncertainty of employers by obtaining a higher qualification certificate (as a signal of costly quality) than lower-quality applicants. The central assumption of signaling theory is that information is asymmetrically distributed between parties. In general, decisions can be made based on public information, which is freely available and private information, which is only available to a subset of the population. Asymmetries arise when private information is only possessed by one party and the other party would potentially make a better decision if it had this information. To alleviate such situations of asymmetry, signals can be used. Furthermore, the most important types of information that can be affected by asymmetry are information about quality and information about intent. The first refers to a situation if one party cannot assess the characteristics of the other party. The second asymmetry occurs when one party is not in the position to evaluate the other party's behavioral intentions (Stiglitz, 2000). In this context, the logic behind it is that the focal company, i.e. insider, has access to private information that others could benefit from. Because of the different characteristics (quality) and intentions (intent), it may use different signals or signaling mechanisms of how to reveal information and what kind of information to reveal to market participants (public). A signal is an activity or attribute which is sent by design or accident, and conveys information or alters the beliefs of receivers (Connelly et al., 2011; Spence, 1973). Besides that, for a signal to be effective and credible, it two prerequisites have to be met: 1) it has to be observable, i.e. receivers are able to detect it and 2) the marginal cost of difficulty of obtaining the signal must be inversely correlated with the actor's quality level (Bird & Smith, 2005; Connelly et al., 2011; Spence 2002). In contrast, cheap talk is a way of conveying information in a costless, non-binding, and unverifiable way to the receiver, but may still affect his believes (Crawford & Sobel, 1982; Farrel and Rabin, 1996). Therefore, cheap talk may be effective and credible if receivers respond or validate to a costless message by the sender, thereby also reducing some level of information asymmetry (Almanzan et al., 2008; Croson et al., 2003; Farrel & Rabin, 1996). The first theory posits that good firms will be able to invest into a costly signal, whereas bad firms are not able or at least face difficulties to cover the costs. In the cheap talk model, good firms have an incentive to engage in costless signaling as they are keen on being discovered, whereas bad firms are in a dilemma. If they refrain from cheap talk, they will be discovered as the good firms have distinguished themselves from them; also they would be revealed if it would engage in cheap talk.

Regarding the cbM&A context, which is particularly prone to information asymmetries, signaling theory and cheap talk may contribute to explain efforts, i.e. costly or costless

signals, of acquirers in different markets depending on the interpretation of the signals by market participants.

Institutional theory puts forward that organizations receive legitimacy by how well they fulfill the expectations of the environment they engage in. Therefore, not only internal, but external features also shape the survival of an organization in a competitive environment (Hybels, 1995). Firms need to some extent adhere to the environment, but also differentiate themselves from others – here in order to be clearly observed and distinguishable by market participants (Deephouse & Carter, 2005; Zajac & Westphal, 2004). Besides having various sources of liabilities, (such as liability of home, liability of foreignness, liability of origin, country of origin), firm-level peculiarities also play a role in (un)favorable outcomes (e.g. Kostova & Zaherr, 1999; Rao, 1994; Sanders & Boivie, 2004; Zaheer, 1995). The latter, for example, could be the length of deal completion and the subsequent lower/higher market evaluations. Hence, the poster juxtaposes the concepts of organizational legitimacy and organizational reputation (Deephouse & Suchman, 2008).

With regard to signaling theory, several signals have been found to be effective and credible. For instance, in the IPO context, third party endorsements (reputable investment banks, prominent venture capitalists, alliances with prominent partners, prior alliances), have been found to have a positive influence on the evaluation, but also on the acquisition likelihood of IPO targets (e.g. Reuer et al., 2012; Reuer & Ragozzino, 2007, 2012). Also, prestigious board directors of IPO firms serve as a signal of legitimacy among investors (Certo, 2003; Filatotchev & Bishop, 2003). In cases of cbM&As, this theory has been applied so far to contingent payouts and stock payments (Hansen, 1987; Reuer et al., 2004), whereby the first method is more likely to be used by firms of higher quality as it can bear possible subsequent costs, thereby acting as an effective signal to target firms. With regard to cheap talk, there is little research on cbM&As. One paper by Angwin et al. (2013) shows that qualitative information can impact on analysts' evaluation of cbM&As in the US and the UK which is not only determined by the announcement of the deal, but by cheap talk that takes place between announcement and closing of the deal. When cheap talk – in the form of (un) favorable interim information – is released, then this will lead to a (lower) higher market capitalization.

This poster seeks to extent signals to ownership structures of EM/DM firms which are characterized by a rather high concentration of ownership (e.g. family ownerships, business group affiliates, state-ownership) (Lebedev et al., 2014). Cuervo-Cazurra et al. (2014) have theorized that when government-owned enterprises engage in cross-border acquisitions they are more likely to engage in legitimacy-enhancing actions such as CSR because they are likely to face more resistance (see also Li et al., 2014). Therefore, ownership concentration and ownership identity would be possible variables to take into consideration. The poster will therefore address whether certain types of liabilities enforce certain types of (costly or costless) legitimacy signals. For example, compared to private companies in AM that are characterized by dispersed ownership, which EM/DM firms will engage in costly or costless signaling in order to reveal their quality? For instance, as high ownership concentration and the identity are likely to face the liability of home, they will probably make use of third party endorsements and/or CSR. However, low quality firms will also probably need a longer period of time until deal completion. Hence, some may just claim unverifiable certifications that are unknown to host market participants. The contribution to the International Business literature is that high-quality firms which suffer from legitimacy issues are more likely to be able to employ costly signals to overcome those as compared to low quality firms. Additionally, it allows market participants to better detect high quality firms.