Information-signaling and competitive effects of foreign acquisitions in the US

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Abstract

The stock price effects for the domestic competitors of foreign acquisition targets in the US are found to be significantly positive. These results imply that signals of favorable industry conditions conveyed through cross-border acquisitions dominate any perceived changes in competitive balance. Consistent with the information-signaling hypothesis, the stock price effects are more favorable for relatively small competitors, for rivals with stock returns that are highly correlated with the target’s stock returns, when the targets experience favorable stock price effects, in technologically-intense industries, for rivals with poor prior performance, and with related acquisitions. Consistent with the competitive hypothesis, the stock price effects are less favorable with high degrees of financial leverage and when the acquirers already have a presence in the US. © 2000 Elsevier Science B.V. All rights reserved.

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1. Introduction

The stock price effects of cross-border acquisitions have received much attention in recent years (e.g., Harris and Ravenscraft, 1991; Kang, 1993; Pettway et al., 1993; Servaes and Zenner, 1994; Eun et al., 1996). These studies focus on the stock price response of the target and/or acquirers and show that shareholders of US targets gain from foreign acquisitions while the shareholders of the foreign acquirers do not consistently gain or lose.

To date, however, there has been no assessment of the stock price effects for the competitors of foreign acquisition targets. Consider the agreement by Daimler-Benz to acquire Chrysler in a stock transaction valued at about US$35 billion on May 7, 1998. This combination was expected to enhance Chrysler’s competitiveness by giving it access to German engineering prowess, and potentially reducing the cashflows to Ford and General Motors. Upon announcement, the market price of Chrysler rose sharply, and the market prices of Ford and General Motors fell at the news of the proposed acquisition. Thus, an announced acquisition of a US firm by a foreign firm could be expected to affect the equity values of the target as well as its local rivals. This paper estimates the impact of foreign acquisitions on the US target firm’s industry rivals and investigates various factors that may explain why those effects differ across acquisitions.

Two competing hypotheses are proposed to describe the stock price response of the target’s rivals. Under the information-signaling hypothesis, foreign acquisitions would indicate that further acquisitions are imminent (Knickerbocker, 1974; Flowers, 1976) and domestic competitors experience a positive stock price reaction as their probability of becoming a takeover target increases. In contrast, under the competitive hypothesis, firms that make cross-border investments possess sufficient competitive advantages to more than offset the inherent disadvantages (Caves, 1971) and domestic competitors experience a negative stock price reaction as the entrance of the foreign acquirers into the industry increases the degree of competition they face.

This study shows that the domestic competitors experience significantly positive valuation effects upon announcement of foreign acquisitions of US firms. Overall, these results provide evidence that signals of favorable industry conditions conveyed through cross-border acquisitions dominate any perceived changes in competitive balance. The evidence in this study is important in light of the direct foreign investment (DFI) theories that argue that DFI may either benefit or adversely affect competitors.

2. Theory and testable hypotheses

Although a single theory to explain DFI has not been developed, the industrial organization view helps to understand the motivation for investing
abroad (e.g., Hymer, 1960; Vernon, 1966; Caves, 1971; Flowers, 1976; Dunning, 1988). These related theories emphasize that market imperfections and the pursuit of leveraging or preserving competitive advantages are the primary motivating factors in cross-border investments. Imperfections may arise naturally from the operation of the firm, may be artificially induced by government policies, or may occur in the financial markets (Scholes and Wolfson, 1990; Froot and Stein, 1991; Harris and Ravenscraft, 1991; Servaes and Zenner, 1994). Examples of some advantages that may be exploited are economies of scale and scope, managerial talent, and technological expertise.

2.1. Information-signaling hypothesis

This hypothesis suggests that acquisitions convey information about the possibility of further takeover activity within the industry, which should benefit the target firm’s competitors. If foreign acquisitions are utilized by aggressive firms to expand geographically, oligopolistic rival reactions are likely to occur (e.g., Knickerbocker, 1974; Flowers, 1976). Foreign firms are more likely to aggressively pursue expansion efforts in the US when DFI is relatively appealing. Thus, announcements of foreign acquisitions in the US may indicate that US assets are relatively appealing and that further acquisitions in the US are probable. Thus, it can be hypothesized that the stock price effects for the domestic competitors of US targets of direct foreign investment are positive. Several factors are examined to determine whether there are cross-sectional differences in the information effects.

Impact of the relative size of the rivals. Based on the work of Atiase (1985), it can be argued that the information-signaling effects are inversely related to the relative size of the rival (e.g., Slovin et al., 1991). Incremental information should be conveyed about relatively small rivals at the time of the announcement, if relatively small firms are less closely followed by the market. In addition, to the extent that larger rivals are more difficult to acquire, the likelihood of further acquisitions involving relatively large rivals is lower.

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1 Direct foreign investment in the US may be relatively appealing for a variety of reasons. First, US assets may be valuable to foreign firms due to market imperfections particular to them in developing, exploiting, or preserving competitive advantages. For example, foreign firms may discover it less costly to coordinate their activities or more effective to identify local product requirements with direct operations in the US. Secondly, foreign firms may find US tax laws relatively advantageous or may desire to avoid tariffs and quotas (Scholes and Wolfson, 1990; Servaes and Zenner, 1994). Thirdly, US assets appear less expensive when foreign currencies are strong relative to the US dollar (Froot and Stein, 1991; Harris and Ravenscraft, 1991).

2 We thank an anonymous reviewer for strengthening this hypothesis.
Thus, it is hypothesized that the information effects are greater (smaller) for relatively small (large) rivals.

**Impact of similar cash flows.** The degree of similarity between the cash flows of the rivals and the cash flows of the targets may help differentiate the rival effects. The announcement of the acquisition indicates that the operating structure of the target is desirable. If an oligopolistic rival reaction is anticipated, rivals with comparable operating structures should be candidates for future takeovers and experience more favorable information effects.

**Impact of other factors.** Incremental information about the future prospects for an industry is revealed in the CARs that accrue to the target and should also have value for the industry rivals. Information effects may be greater for rivals in industries that are more attractive to foreign firms, thus related acquisitions may signal industry consolidation and indicate further acquisitions within the industry.

### 2.2. Competitive hypothesis

This hypothesis is based on the idea that acquisitions may adversely affect the future performance of the target’s rivals. DFI theories imply that firms must possess substantial competitive advantages to more than offset their inherent disadvantages from operating abroad, such as managing geographically dispersed operations and conducting business in an unfamiliar culture and environment (e.g., Caves, 1971). To the extent that foreign acquirers overcome their inherent disadvantages with convincing

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3 Lang and Stulz (1992) present a similar argument where the information effect is expected to be larger when rivals have similar cash flows.

4 If the current acquisition is an oligopolistic reaction to a previous acquisition, rivals with similar cash flows may be viewed as the “losing” targets, even if the rivals had not been formally or publicly under consideration. In this case, rivals with similar cash flows would experience less favorable information effects.

5 Hertzel (1991) implies that the larger the impact of announcements on the targets the greater the information signal.

6 Foreign firms competing in the US may possess a variety of advantages over domestic firms. First, the nature of financial and managerial decisions made by foreign managers may differ from domestic managers (e.g., Doyle et al., 1992). Secondly, foreign firms may more effectively capitalize on basic research. Eun et al. (1996) provide some evidence that cross-border acquisitions of US firms are synergistic due to research and development capabilities. Additionally, the products of foreign firms are sometimes perceived to have superior quality (e.g., Shapiro, 1996).
advantages, resulting in a net advantage, the stock price effects for the target firm’s rivals are hypothesized to be negative. Several factors are investigated to determine whether there are cross-sectional differences in the competitive effects.

**Impact of financial leverage.** Financial leverage may limit a firm’s ability to make investments to respond to competitive challenges (Stulz, 1990). Therefore, it is hypothesized that rivals with higher degrees of financial leverage incur more negative competitive effects due to their limited ability to expeditiously compete.

**Impact of the degree of competition.** Another factor that is explored is the degree of competition within the industry. It can be argued that rivals in highly competitive industries experience greater competitive effects. Since rivals in competitive industries are already aggressively competing, the additional challenge from a foreign rival with presumably net competitive advantages may have a more detrimental impact. However, a detrimental impact on the rivals may also occur in less competitive industries, but for a different reason. Industries with a low degree of competition tend to participate in collusive behavior (Sudharshan, 1995). In this environment, the foreign competitors may not be as likely to join the coordination efforts, thus may adversely impact the rivals.

**Impact of the rivals’ prior performance.** Rivals that have had poor performance prior to the acquisition are not likely to be positioned to effectively compete with a newentrant. Thus, it can be hypothesized that underperforming rivals are more adversely affected by the acquisition. Alternatively, underperforming rivals may be expected to improve their performance due to the threat of an acquisition or an actual acquisition. Upon announcement, this information-signal may favorably impact the returns of poor performing rivals.

**Impact of other factors.** Related acquisitions are more likely to achieve economies of scale or scope (e.g., Caves, 1971). Foreign acquirers with prior US experience may not suffer as greatly from the inherent disadvantages from operating abroad and instead are able to focus on their competitive strengths, and the real or perceived competitive threat may be greater depending upon the acquirer’s country of origin.

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7 Hennart and Park (1993) argue that acquisitions of existing US operations, as opposed to establishing new US subsidiaries, are used by Japanese firms that do not have strong competitive advantages. If acquisitions are generally used by foreign firms that do not have strong competitive advantages, the competitive effects described here may not be elicited.

8 If the rival firms in less competitive industries are expected to focus on improving their performance as a result of new competition, the rival effects would be positive.
3. Sample characteristics and valuation methodology

3.1. Sample characteristics

To be included in the sample of foreign acquisitions made in the US, the following selection and screening techniques are used:
1. Foreign acquisitions of US firms are listed in *Mergers and Acquisitions* with completion dates between 1985 and 1996.
2. The bidder gains at least 50% control of the target.
3. The target has stock price data available on NYSE, ASE, or NASDAQ CRSP files at the time of the acquisition announcement.
4. Acquisition announcement dates are available in *Predicast's F & S*. The announcements are screened for confounding events. Some announcement dates are in 1984 for acquisitions completed in 1985.
5. The announcements are made in daily publications such as the *Wall Street Journal, New York Times, Financial Times*, etc.

The final sample consists of 165 acquisition announcements over 1984–1996. A wide range of industries are represented in the sample with 119 distinct four-digit SIC codes included. Table 1 summarizes the sample distribution by event year and country. Note that 94 (57%) of the 165 acquisitions occurred in the late 1980s (1986–1989). British firms conducted the most acquisitions (40%) in this sample.

Table 2 provides further summary statistics on the targets and their industry rivals. These statistics are provided for three different definitions of industry rivals, US firms that share the same four-digit, three-digit, and two-digit SIC code with the target at the time of the acquisition announcement. The SIC codes are provided in the CRSP files. The mean market value of the targets is $1.1 billion, while the mean market value of the rivals ranges from $1.4 billion (two-digit SIC code definition) to $2.0 billion (four-digit SIC code definition). The mean, median, minimum, and maximum number of rivals per event are also provided. As expected, the mean, median, and maximum number of rivals increase as the definition of ‘rival’ is broadened.

3.2. Valuation methodology

The valuation effects of foreign acquisitions in the US are estimated for equally-weighted portfolios of the industry rivals for each announcement. A simple market model is used to predict daily share price returns, with a 200-day estimation period from 220 days before the announcement to 20 days before the announcement for each portfolio of rivals. Daily returns for the

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9 We find qualitatively similar results when the SIC codes from *Compustat* are used.
Table 1

The sample distribution of 165 foreign acquisitions of US targets by year and by country\(^a\)

<table>
<thead>
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<td>2</td>
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<td>0</td>
<td>3</td>
<td>7</td>
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<td>2</td>
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<td>0</td>
<td>1</td>
<td>1</td>
<td>2</td>
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<td>0</td>
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<td>0</td>
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<td>2</td>
<td>2</td>
<td>0</td>
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<td>Netherlands</td>
<td>8</td>
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<td>0</td>
<td>2</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>0</td>
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<td>0</td>
<td>0</td>
<td>0</td>
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<tr>
<td>Other(^b)</td>
<td>23</td>
<td>1</td>
<td>1</td>
<td>4</td>
<td>2</td>
<td>4</td>
<td>4</td>
<td>1</td>
<td>1</td>
<td>0</td>
<td>1</td>
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<td>4</td>
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<td>16</td>
<td>24</td>
<td>27</td>
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<td>5</td>
<td>2</td>
<td>6</td>
<td>9</td>
<td>15</td>
<td>9</td>
</tr>
</tbody>
</table>

\(^a\) The sample of 165 foreign acquisitions of US firms is derived from *Mergers and Acquisitions* with completion dates between 1985 and 1996, where the bidder gains at least 50% control of the target, the target has stock price data available, and announcement dates are available in *Predicast’s F & S* from daily publications.

\(^b\) Includes acquirers from Argentina, Australia, Belgium, Ireland, Israel, Italy, Mexico, South Korea, Sweden, and Taiwan.
The rivals are taken from the CRSP files to create an equally-weighted rival portfolio. The CRSP equally-weighted index is used as a proxy for the market.

Daily abnormal returns are then calculated over an examination period of 21 days, from 10 days pre-announcement to 10 days post-announcement. Based on the hypotheses in this study, positive abnormal returns support the information-signaling argument and negative abnormal returns support the competitive argument. \( z \)-Statistics are calculated using the methodology of Mikkelson and Partch (1988).

4. Results

4.1. Valuation effects

Table 3 reports the valuation effects for US targets acquired by foreign firms and their corresponding rival portfolios. Panel A reports the valuation effects for the 165 targets. On average, the 2-day event period cumulative AR (CAR) is 23.39% and significant at the 0.001 level. This result is consistent with the aforementioned studies that document favorable valuation effects for targets upon the announcements of acquisitions.

The valuation effects of the rival portfolios are provided in Panels B, C, and D of Table 3. These panels report the valuation effects for the rival portfolios using three different definitions for ‘rival’. When the rivals are defined as those firms that share the same four-digit SIC code (Panel B), the 2-day event period mean CAR is 0.50% and significant at the 0.001 level. Panel C (Panel D) reports the valuation effects as 0.48% (0.23%) when the rivals are defined as those firms that share the same three-digit (two-digit) SIC code.

Excluding losing bidders from the rival portfolios does not significantly change the rival portfolio effects.
Thus, it appears the rival stock price effects are somewhat robust to the definition of ‘rival’. Although, the effects are reduced as a more broad definition of rival is used.

In this study, industry rivals will be primarily defined as those firms with the same four-digit SIC code as the target (Hertzel, 1991; Slovin et al., 1991; 1992; Szewczyk, 1992). Industry rivals defined in this manner are available for 120 of the 165 acquisitions. In those cases where there are no rival firms with the same four-digit SIC code at the time of the announcement, the rivals are identified using firms with the same three-digit SIC code. Using this approach, the 2-day event period mean CAR is 0.44% and significant at the 0.001 level.

The results in Table 3 indicate that the information-signaling effects dominate the competitive effects. This evidence is interesting in light of the DFI theories that suggest cross-border acquisitions could either benefit or adversely affect competitors.

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Table 3
Valuation effects for US targets acquired by foreign firms and their corresponding industry rival portfolios, defined by CRSP four-digit, three-digit and two-digit SIC codes

<table>
<thead>
<tr>
<th>Examination period</th>
<th>CAR</th>
<th>z-Statistics</th>
<th>% Pos</th>
</tr>
</thead>
<tbody>
<tr>
<td>Panel A: US targets acquired by foreign firms</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pre-event period (−11,−2)</td>
<td>0.0698</td>
<td>12.11d</td>
<td>63</td>
</tr>
<tr>
<td>Event period (−1,0)</td>
<td>0.2339</td>
<td>80.95d</td>
<td>91</td>
</tr>
<tr>
<td>Post-event period (+1,+10)</td>
<td>−0.0020</td>
<td>0.19</td>
<td>47</td>
</tr>
<tr>
<td>Panel B: industry rivals of US targets, defined by four-digit SIC</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pre-event period (−11,−2)</td>
<td>0.0006</td>
<td>−0.71</td>
<td>46</td>
</tr>
<tr>
<td>Event period (−1,0)</td>
<td>0.0050</td>
<td>3.61d</td>
<td>56</td>
</tr>
<tr>
<td>Post-event period (+1,+10)</td>
<td>−0.0009</td>
<td>0.13</td>
<td>47</td>
</tr>
<tr>
<td>Panel C: industry rivals of US targets, defined by three-digit SIC</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pre-event period (−11,−2)</td>
<td>0.0038</td>
<td>0.78</td>
<td>47</td>
</tr>
<tr>
<td>Event period (−1,0)</td>
<td>0.0048</td>
<td>3.53d</td>
<td>58</td>
</tr>
<tr>
<td>Post-event period (+1,+10)</td>
<td>−0.0010</td>
<td>0.39</td>
<td>51</td>
</tr>
<tr>
<td>Panel D: industry rivals of US targets, defined by two-digit SIC</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pre-event period (−11,−2)</td>
<td>0.0013</td>
<td>0.95</td>
<td>51</td>
</tr>
<tr>
<td>Event period (−1,0)</td>
<td>0.0023</td>
<td>3.55d</td>
<td>59</td>
</tr>
<tr>
<td>Post-event period (+1,+10)</td>
<td>0.0014</td>
<td>0.44</td>
<td>49</td>
</tr>
</tbody>
</table>

\*The reported CARs are cumulative abnormal returns over three different examination periods. d denotes significance at the 0.001 level. The average abnormal return and z-statistics can differ in sign because the former assigns uniform weights to each observation and the latter assigns non-uniform weights (see Mikkelson and Partch, 1988).

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11 This scheme is also applied to generating the cross-sectional variables.
12 The distribution of the 2-day CARs does not reveal a majority of firms with large, positive ARs. Of the 165 rival portfolios, 95 accumulate positive CARs, 70 accumulate negative CARs, and 86 accumulate between plus and minus 1%.
4.2. Cross-sectional regression analysis of rival stock price effects

Differences in the valuation effects across the domestic competitors are explored using regression analysis. Based on the information-signaling hypothesis, we expect a more positive rival stock price response for relatively small rivals, for rivals with similar cash flows, when the targets experience positive stock price effects, and for rivals in industries that are more attractive to foreign firms. Based on the competitive hypothesis, we expect a more negative rival stock price response for highly leveraged rivals, for rivals operating in industries with a high or low degree of competition, for poorly performing rivals, and when the acquirer already has an established presence in the US.

Relative size (RELSIZE). This variable takes on the value of one for relatively small rivals, and zero otherwise. Market values are calculated as the number of common shares outstanding multiplied by the share price

Correlation in stock returns (CORR). As a proxy for the similarity in cash flows, the correlation between the stock returns of the target and the rival portfolio is calculated over the 200-day period ($t_{-220}$ to $t_{-20}$) prior to the acquisition announcement.

Target abnormal return (TARGAR). The 2-day cumulative abnormal return for each target is calculated in the same manner as the rival portfolio.

Financial leverage (FLEV). This industry-specific variable is defined as the median ratio of total long-term debt to total equity of the rivals.

Degree of competition (COMP). The Herfindahl index is used as a proxy for the degree of competition. It is defined as the squared sum of the fractions of industry market capitalization by the rival firms. An industry is considered less competitive with a greater Herfindahl index.

Performance (PERFORM). The average monthly abnormal return for each rival is estimated over the 12 month period prior to the acquisition announcement. The median AR of the rivals is used to indicate the prior performance of the industry rivals.

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13 A continuous variable, measured as the ratio of the market value of the target to the median market value of the rivals, is also considered. However, after removing outliers, the results are essentially the same as those reported.

14 The information effects may not be driven by the size of the rivals, but instead it may be driven by the size of the targets. Szewczyk (1992) implies that acquisitions of large targets convey more information than acquisitions of small targets.

15 These data are taken from Compustat. In order to generate the financial leverage variable for the industry rivals, a two-digit SIC code definition is used in seven cases, a three-digit SIC code definition is used in 61 cases, and a four-digit SIC code definition is used in 97 cases.

16 The results are qualitatively the same when COMP is defined as the squared sum of the fractions of industry sales.
Currency strength (XSTRENGTH). The relative strength of the bidder’s currency is used as a control variable. This variable is estimated following Harris and Ravenscraft (1991), Cebenoyan et al. (1992). Positive (negative) values of XSTRENGTH occur when the bidder’s currency is weak (strong) relative to the US dollar. The exchange rates are in units of foreign currency per US dollar and are available in the Wall Street Journal.

Dummy variables. The rival effects are also examined for cross-sectional variation by industry, the relatedness of the acquisition at the two-digit SIC code level, and the acquirer’s prior presence in the US using dummy variables.

Table 4 displays the results of the regression analysis. To control for heteroskedasticity, the variables have been standardized by the standard error of the model used to estimate the abnormal returns. The variance inflation factors (VIFs) are reported to assess the extent of multicollinearity. The VIFs range from 1.16 to 1.93, indicating multicollinearity is not substantially influencing the coefficients.

The cross-sectional results provide evidence supporting both the information-signaling and competitive hypotheses. More specifically, RELSIZE is found to be positive and significant. As hypothesized, the information effects are greater (smaller) for relatively small (large) rivals.
The valuation effects are greater for rival portfolios when their stock returns are highly correlated with the returns of the target (CORR). To the extent that an oligopolistic rival reaction is anticipated, rivals with similar cash flows may be candidates for future takeovers.

The stock price effects of the rivals are directly related to the stock price effects of the targets (TARGAR). This intra-industry effect reveals that the target response is also valuable for the rivals.

Rival portfolios experience positive and significant effects in technologically-intense (DUMTECH) industries. Thus, it would appear that technologically-intensive industries benefit from the possibility of future takeover activity.

Rivals with poor performance prior to the acquisition (PERFORM) are favorably affected by the acquisitions. This information effect reveals the expectation of future performance improvements either due to the threat of takeover or an actual takeover.

Table 4
Cross-sectional factors of the rival effects of foreign acquisitions in the USa

<table>
<thead>
<tr>
<th>Variables</th>
<th>Coefficients</th>
<th>t-Statistics</th>
<th>VIF</th>
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</thead>
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<tr>
<td>Intercept</td>
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<td>-1.41</td>
<td>0.00</td>
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<tr>
<td>RELSIZE</td>
<td>0.0148</td>
<td>1.92a</td>
<td>1.16</td>
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<td>CORR</td>
<td>0.0663</td>
<td>3.58d</td>
<td>1.36</td>
</tr>
<tr>
<td>TARGAR</td>
<td>0.0381</td>
<td>2.84d</td>
<td>1.28</td>
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<td>DUMTECH</td>
<td>0.0165</td>
<td>2.09d</td>
<td>1.50</td>
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<td>DUMIND</td>
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<td>0.53</td>
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<td>COMP</td>
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<td>-1.48</td>
<td>1.28</td>
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<td>PERFORM</td>
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<tr>
<td>XSTRENGTH</td>
<td>-0.0132</td>
<td>-0.52</td>
<td>1.51</td>
</tr>
</tbody>
</table>

Sample size 165
F-value 12.28d
Adj. R² 0.4321

The dependent variable is the rival portfolio two-day cumulative AR. a, b, c, and d denote significance at the 0.10, 0.05, 0.01, and 0.001 levels, respectively. RELSIZE = 1 if target market value > median market value of rivals, 0 otherwise; CORR = median correlation between target and rivals stock returns over t - 220 and t - 20; TARGAR = target two-day CAR; DUMTECH = 1 if target industry is technologically-intense, 0 otherwise; DUMIND = 1 if target industry is manufacturing but not technologically-intense, 0 otherwise; FINLEV = median debt/equity of rivals; COMP = Herfindahl index; PERFORM = median of the rivals average AR over 12 months prior to the acquisition announcement; RELATED = 1 if target has same two-digit SIC code as acquirer, 0 otherwise; PRIORP = 1 if acquirer has prior presence in the US, 0 otherwise; XSTRENGTH = difference of the average exchange rate of the dollar (domestic currency per US dollar) over 1984-1996 and the exchange rate in the year of the announcement divided by the average exchange rate of the dollar. VIF statistics are reported to demonstrate that multicollinearity is not substantially influencing the coefficients.
RELATED is found to be positive and significant which is consistent with the information effect. Related acquisitions can signal consolidation in the industry and indicate that further acquisitions are imminent.

Consistent with the competitive hypothesis, PRIORP is significant and negative. Hence, foreign acquirers that have already established a US presence evidently adversely affect their US rivals. This relationship may occur if the inherent disadvantages from operating abroad that Caves (1971) discusses have been alleviated through their experience, allowing the foreign acquirer to now focus on their competitive advantages.

In the regression results, FLEV is not shown to be statistically significant. However, when only those firms with the greatest degrees of financial leverage are examined, a significant and negative relationship is detected. Thus, there is some support for the competitive effects of financial leverage.

5. Summary

This study provides evidence that, on average, the stock price response of the rivals of US targets of foreign acquisitions is positive and significant. These results indicate that the information-signaling effects resulting from cross-border acquisitions outweigh the competitive effects. These empirical results are informative since the DFI theories argue that industry rivals may either benefit or be adversely affected by direct foreign investment.

The cross-sectional analysis finds evidence supporting both the information-signaling and competitive hypotheses. Consistent with the information-signaling hypothesis, the stock price response of target rival firms is more favorable for relatively small rivals, for rivals with stock returns that are strongly correlated with the stock returns of the target, when the targets experience favorable valuation effects, in technologically-intense industries, for rivals with poor prior performance, and with related acquisitions. Consistent with the competitive hypothesis, the stock price response of target rival firms is less positive when the industry has a high degree of financial leverage and when the acquirers already have an established presence in the US.

\[22\] COMP is also not statistically significant. Although, not detecting a strong relationship between the degree of industry competition and the rival effects was anticipated due to offsetting forces.
References


