

Working capital and mergers and acquisitions transactions by emerging market acquirers

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Abstract

This study investigates whether working capital positions of emerging market acquirers drive mergers and acquisitions (M&As) transactions they execute and further explore if it influences these acquirers' decisions on the type of merger deals they pursue. We use a cross-section of 160 listed firms from ten (10) emerging market countries over the period of 2004 to 2013 and employ the probit regression technique to explore the likelihood of working capital of these firms to motivate to undertake M&A deals. The results suggest that working capital positions of emerging market acquirers are less likely to drive them to undertake acquisition deals. However, the study reveals the marginal effect coefficient for the firms' total assets to be positive and statistically significant at 1%, suggesting that the firms' level of total assets rather is more likely to influence them to execute acquisition transactions, all other things being equal. There is no evidence of the firms' level of financial leverage, ROAs and Tobin's Q having the possibility of influencing the acquirers to pursue M&As. Finally, regarding whether working capital again influences the type of M&As these firms execute, the results indicate that it is less likely to encourage these acquirers to pursue either horizontal or vertical type of merger.

Keywords: Working capital; mergers and acquisitions; probit regression; emerging markets.

1. Introduction

Activities of M&As some time ago concentrated on strategic transactions involving integration and diversification (Sagner, 2007). In recent times, however, the goal of the M&A game is focused more on either gaining balance-sheet assets, particularly in the light of hoards of underperforming cash or to improve on the acquired company's working capital management. This appears to be a complete departure from the way firms and investment bankers perceive potential M&A companies to be, which raises concerns about what is happening in the markets.

As a characteristic, M&A transactions usually involve an adjustment to working capital as an important element of the purchase price. The acquirer firm expects to confirm that, it purchases a firm with enough working capital to satisfy the conditions or the requirements of the business after closing, including commitments to trade creditors and customers (Kerrigan, 2012). The target firm to be acquired also wants the asset infrastructure that made it possible for the business to exist, operate and generate the profits which attracted the acquirer to be considered. This means that firms' working capital position is a major factor which is considered in M&A deals.

An interesting development in recent times, however, is that companies are being accused of having in excess of about \$1 trillion working capital which is much larger than what is considered prudent according to (Rel Consulting, 2016). Ernst & Young (2017) also reports of working capital performance of the leading 500 companies headquartered in India and accuses these companies of having approximately \$ 60 billion excess in working capital. In some cases, it is suggested that companies may be reserving cash in anticipation of M&A activities (Rel Consulting, 2016, 2017). This situation seems contrary to the argument that the working capital management theory advances that, firms must keep a healthy balance between liquidity and profitability since a good working capital management balances the conflicting goals of liquidity and profitability and maximizes shareholder value. This leaves questions in the minds of many and therefore makes a case for investigations into the role working capital may be playing in recent surge of M&A transactions, particularly deals involving emerging market firms as acquirers. This is because working capital positions of firms appear to have been ignored in the numerous studies on drivers of M&As by acquirers from the emerging markets. Some of the frequently cited drivers of M&A deals by firms from this region (emerging markets) have been; to seek for natural resources (Gaur, Kumar & Singh, 2014; Stucchi, 2012), because

of institutional reforms in some of the emerging market countries (Meyer *et al.*, 2009; Kim & Lu, 2013), as a means to compensate for emerging market firms' latecomer-disadvantages in the areas of managerial and technological capabilities, brand recognition, consumer base and innovation, (Luo and Tung, 2007), to seek for different forms of synergies (Rani, Yadav & Jain, 2012), as a means to fill the capability gaps of these firms' (Cogman *et al.*, 2015), to diversify and expand internationally (Boateng *et al.*, 2008), to escape from home competition (Hashim, 2012) and also due to the various limitations of these firms respective domestic markets (UNCTAD, 2006).

The main objective of this study, however, is to investigate whether working capital positions of emerging market acquirers motivate them to undertake M&A deals, and further explore if it influences them to pursue a particular type of merger deal (that is, either a horizontal, vertical or conglomerate merger). We use a cross-section of 160 listed acquirer firms from ten (10) emerging market countries over the period of 2004 to 2013 and employ the probit regression technique to determine the relationship between working capital positions and M&As transaction of acquirers from the emerging markets. To the best of our knowledge, no existing studies have investigated whether working capital positions motivate acquisition deals by firms from emerging markets. These acquirers also make several decisions including the type of merger deals they become interested in pursuing. As a result, this study also explores the influence of working capital on the type of merger deal these acquirers decide to execute. The present study, therefore, contributes to the extension of literature on drivers of M&As by acquirers from the emerging markets. The results suggest that working capital positions of emerging market acquirers are less likely to encourage them to undertake acquisition deals and also become interested in a particular type of M&A transaction.

The rest of the paper is organized as follows: Section 2 presents the literature review (that is, both theoretical and empirical) and hypotheses testing. Section 3 deals with data and methodology while Section 4 looks at results and discussions. Section 5 finally presents the conclusion and recommendations of the study.

2. Literature review and hypothesis testing

2.1. Theoretical framework

The following theories are applied for this study to investigate whether working capital positions of emerging market acquirer firms drive their M&A

transactions, and further explore if it also influences them to decide on a specific type of merger deal.

Working Capital Management Theory; this theory describes how working capital ought to be managed. It reveals the benefits regarding profitability, liquidity, solvency, efficiency and maximization of shareholders' wealth which accumulates to the firm from properly managing its working capital well (Brigham, *et al.* 1999, Gitman, 1997). It stresses that working capital management involves choosing between having more liquidity and less profitability or vice versa. Firm liquidity is concerned with ensuring that the firm has sufficient financial resources to pay its maturing short-term obligations. Holding liquid resources is important to enable firms to continue their operations since inadequate liquidity can result in insolvency and eventual failure of the business (Dunn and Cheatham, 1993). Decisions that promote liquidity such as carrying high levels of current assets usually affect the profitability potential of the firm since funds would have been accrued to the firm earning either very low or negative returns (Bhattacharya, 2009).

Liquidity hypothesis; according to this hypothesis, the possibility of firms becoming targets in acquisitions transactions increases as their liquidity positions also increase (Song and Walking, 1993). This is made possible since excess liquidity allows the acquirer to rely on the target firm's own resources to finance the acquisition deal. Contrarily, the availability of liquidity to firms can have an adverse effect on the firm's desire to achieve their objectives if the level of flexibility they have in using it is not managed well. The free cash flow hypothesis as advanced by Jensen (1986) suggests that managers are potentially able to expand their firms beyond the optimal size or execute unprofitable projects if they are endowed with large amount of free cash. This is because excess cash reserves can be seen as hoarded free cash, and this may result in agency conflicts over the disposal of that cash. As a result of these views, it can be realized that mergers and acquisitions represent speedy way firms make use of cash available to them instead of disbursing to shareholders. This means that, when a company or a business entity accumulates cash in excess of what is considered normal for its operations within a time period, the possibility of it to engage in M&As is high (Harford, 1999).

Theory of managerial discretion; this theory is basically founded on the claims by the liquidity hypothesis that unproductive acquisitions are not driven by over-confidence, but it is due to availability of free cash flow or more liquidity. Firms

with internal funds that are considered more than what is needed to finance projects with positive net present value tend to make quick strategic investment decisions, and the possibility of them engaging in large-scale investments without proper analysis compared to their cash-strapped counterparts is high. High amounts of liquidity tend to increase managerial discretion, which gives an opportunity to managers to select bad acquisitions, particularly when they do not have many good deals to choose from (Martynova and Renneboog, 2008).

2.2. Empirical review

Several studies have attempted to investigate drivers of emerging market firms' acquisitions decisions by considering different push and pull factors. For instance, Gaur, Kumar and Singh (2014) and Stucchi (2012) state that, the ability of firms to secure a continuous and reliable supply of key natural resources is a major driving factor for M&As by firms from the emerging economies.

Another driver that scholars identify as a motivating factor of emerging market acquirers' M&A pursuits is institutional reforms in home countries (Athreye & Kapur, 2009; Gaur et al., 2014; Morck, Yeung, & Zhao, 2008). For instance, Nayyar (2008) suggests the liberalisation of government policies toward FDI as one key driver of M&As for Indian acquirers. It contributed immensely to the rapid increases in India's OFDIs (outward foreign direct investments) from 2000 to 2007. That policy from the government helped to remove the barriers that prevented local firms from cross-border acquisitions (Duppati & Rao, 2015). According to Meyer *et al.* (2009), another positive driver of M&As pursued by acquirers from the emerging markets is stronger institutions. They find that emerging market countries whose economies are supported by stronger institutions become attractive acquisition destinations to other firms from the region. Luo and Tung (2007) also identify that emerging market firms' latecomer-disadvantages in the areas of managerial and technological capabilities, brand recognition, consumer base and innovation motivate firms from developing economies to pursue acquisitions, purposely for growth and expansion. In investigating foreign acquisitions by Lenovo, Huawei and Nanjing (all are Chinese firms), Rui and Yip (2008) state that, the main goals for these companies' M&A activities were to compensate for the various home market shortcomings and also take advantage of what foreign competition could afford them. Other interesting factors that are highlighted to influence emerging market firms to undertake M&As include: to achieve synergistic benefits (Rani, Yadav, and Jain (2012), to fill the capability gaps due to emerging market firms' limited access they have to strategic resources and intangible assets

such as managerial capabilities (Cogman *et al.*, 2015), for diversification and international expansion (Du *et al.*, 2015), to escape from home competition (Cuervo-Cazurra & Ramamurti, 2014; Luo & Tung, 2007) and to overcome the limitations of their respective domestic market (Rasiah & Gammeltoft, 2014).

It is clear from the foregoing discussion that, there are many motives and factors that influence acquisitions by emerging market firms. However, the role firms' working capital may be playing in motivating acquisitions decisions by acquirers from the emerging markets seem to have been overlooked or ignored despite the overwhelming evidence of excess reserve of firms' working capital appearing on companies balance sheets. For instance, in the year 2007, according to Wasiuzzaman and Arumugam (2013), the top 850 companies in the Asia-Pacific region were holding approximately \$833 billion in excess of working capital that was not properly being utilised. Ernst & Young (2016) also accuses the 500 leading firms situated in India of having around \$60 billion excess of working capital after reviewing their working capital performances. Further, large cash reserves in the form of working capital are also reported as a key factor that will motivate M&A deals, according to KPMG (2015) M&A survey report. Chance (2016) also adds that the number of deals will continue to increase since there is about \$1.3 trillion of working capital for deals executions.

The foregoing discussion thus constitutes the gap that this study attempts to fill by examining whether working capital positions of acquirer firms from the emerging markets drive M&A transactions they execute or not. This is because, to the best of our knowledge, no studies have explored whether working capital positions of acquirers from the emerging markets motivate or drive them to undertake M&A transactions. This study again departs from previous studies on drivers of M&As by emerging market firms who largely rely on firms within one country which makes generalisation of findings and conclusions quite difficult. The present study, however, considers firms from ten (10) different emerging market countries altogether to investigate if their working capital positions influence their acquisition pursuits. We, therefore, put forward the following hypotheses that;

H1: Working capital positions of acquirers from the emerging markets are more likely to motivate them to undertake M&As.

H2: Working capital positions of acquirers from the emerging markets are more likely to motivate them to undertake either a horizontal or vertical type of M&As.

3. Data and methodology

3.1. Data

The study uses firm-level dataset of acquiring firms from the emerging markets gleaned from the Bloomberg database from 2004 to 2013. The main reason for the selection of the time period is the availability of data, and also, several countries in the emerging markets experienced a substantial rise in M&A activities because of implementation of various regulatory and structural reforms. The dataset consists of annual financial information such as working capital, financial leverage, Tobin's Q, Total Assets, Total debt and records of M&A deals of acquiring firms from 10 emerging market countries of: South Africa, Brazil, Russia, Malaysia, Argentina, Poland, China, India, Mexico, and Chile. The country selection is basically motivated by availability of data. The records of M&A deals cover the date of announcement, the type of merger, public firms, mode of payment (cash, equity, or both); and the industry of the acquiring and target firms. For an acquiring firm to be included in the sample, the firm must be listed on one of the exchanges in the 10 identified countries. Similar to Liu, Padgett and Varotto (2017), the study included only nonoverlapping deals. That is, we excluded acquirers that made multiple acquisitions within a year or consecutive years. Our final sample, therefore, is made up of 160 acquirer firms.

3.2. Methodology

The main objective of this study is to investigate whether working capital positions of emerging market acquirers drive M&A transactions they execute. The study further explores whether working capital has an influence on the type of merger transactions (either horizontal, vertical or conglomerate mergers) that firms from the emerging markets pursue.

We employ a cross-sectional analysis, using a probit regression technique. According to Brooks (2014), the probit model is well suited than the OLS if the dependent variable is binary and takes not more than two values, an example can be, one (1) if a merger transaction is horizontal and zero (0) otherwise. This model seeks to estimate the likelihood that a certain observation that has specific characteristics will find itself within one of the specific categories.

A probit regression method is considered powerful when the purpose of a research study is to establish the probability of an event occurring or the likelihood of its occurrence. This method was used to avoid the limitations of OLS and multiple discriminant analysis (MDA). Two key requirements for

discriminant analysis are that data should have multivariate normal distribution and the dispersion matrices of the group must be the same. Neter and Wasserman (1974) state both theoretical and empirical considerations and suggest that, when the dependent variable is binary, the underlying relationship is frequently curvilinear. In probit analysis, no assumptions need to be made about the prior probability that, the firm belongs to a specific group, and the assumptions of normal distribution and the equality of variances and covariances across groups are less critical.

Suppose a response variable Y is binary, it can have only two possible outcomes which we will denote as 1 and 0. Y , for example, may represent M&A executed firms and non-M&A executed firms. We also have a vector of regressors X , which are assumed to influence the outcome Y . Specifically, we assume that the model takes the form:

$$\Pr(Y = 1 | X) = \Phi(\beta_0 + \beta_1 X) \quad (1)$$

where \Pr denotes the probability that an event occurs (that is $M\&A$) given the values of the X variables and Φ is the standard cumulative distribution function (CDF). The parameters β are typically estimated by maximum likelihood. In Equation 1, if β_1 is positive, then an increase in X increases the probability that $Y=1$; if β_1 is negative, then an increase in X decreases the probability that $Y=1$.

The probit methodology has been used in several studies relating to mergers and acquisitions by different scholars such as (Andriosopoulos & Lasfer, 2015; Huang, Officer, & Powell, 2016) respectively. This study in line with the above scholars therefore also specify a probit regression model as shown in Equation 2 below to investigate whether working capital drives M&A transactions by emerging market acquirers:

$$DM\&A_{Fi} = \beta_0 + \beta_1 WC_i + \beta_2 ROA_i + \beta_3 TA_i + \beta_4 TQ_i + \beta_5 FIN_i + \varepsilon_i \quad (2)$$

where $DM\&A_{Fi}$ represents a dummy variable for mergers and acquisitions of firms, which is denoted by one (1) if a firm executed M&A and zero (0) otherwise. Our main explanatory variable for this study which we expect to be driving M&As transactions by emerging market acquirers is working capital of these acquirers represented by WC (working capital). This refers to a company's investments in both current assets and net working capital and is computed as the firm's current assets minus its current liabilities. A priori, based on the financial theory, we expect that WC will more likely drive M&As transactions by these acquirer firms. ROA , TAs (total assets), TQ (proxy for firms' growth

opportunity) and *FIN* are the control variables representing the firms' return on asset (for profitability levels), total assets (proxy for firm sizes), *Tobin's q* (proxy for firms' growth opportunities) and financial leverage levels respectively. ε_i and i denote the random error term and the cross-sectional dimensions respectively. $\beta_1, \beta_2, \beta_3, \beta_4,$ and $\beta_5,$ are the coefficients to be estimated. We expect a positive relationship between the various control variables and M&As.

Linked to the above investigation of whether working capital drives M&As transactions by emerging market acquirers, is a further investigation of whether it (that is, working capital positions of the firms) also has any influence on the type of merger transactions (either horizontal, vertical or conglomerate mergers) they pursue.

This study, therefore, in line with Catão and Milesi-Ferretti (2014) and Clare *et al.* (2013) undertakes this investigation according to the following model specification;

$$DM\&A_{Fi} = \beta_0 + \beta_1 WC_i + \beta_2 ROA_i + \beta_3 TA_i + \beta_4 TQ_i + \beta_5 FIN_i + \varepsilon_i \quad (3)$$

where; *MATPE* denotes a dummy variable for the type of M&A deal (either horizontal merger, vertical merger or conglomerate merger) that emerging market acquirer firms pursue. It assumes a value of one (1) if the merger is horizontal or vertical and zero (0) otherwise. *WC*, *ROA*, *TAs* (total assets), *TQ* (proxy for firms' growth opportunity) and *FIN* are a set of control variables denoting firms' working capital, returns on assets (for profitability levels), total assets (proxy for firm sizes), *Tobin's q* (proxy for firms' growth opportunities) and financial leverage levels, respectively. ε_i and i denote the random error term and the cross-sectional dimensions respectively. $\beta_1, \beta_2, \beta_3, \beta_4, \dots, \beta_5,$ are the coefficients to be estimated. We define the various types of mergers as follows:

- (a) *Horizontal merger*: It involves the combination of firms with a similar line of products that are identical or related and usually operates in the same industry (Fan & Goyal, 2006).
- (b) *Vertical merger*: It occurs when firms producing distinct goods and services or parts used in producing a particular final product combine to form a new firm (Fan & Goyal, 2006). For instance, a manufacturer of a product may decide to join with the supplier. These firms generally may be operating at different stages of the production chain.
- (c) *Conglomerate mergers*: This type of merger occurs when two or more firms whose business operations are not related either horizontally or vertically combine to create a single business entity (Amihud *et al.*, 1981).

4. Results and discussion

4.1. Summary statistics

Table 1 presents the statistical summary of the variables considered in this study with 322 observations taken from 160 emerging market acquirer firms over the period of 2004 to 2013. The variation of the data set is minimal as reflected by the low standard deviation. The results show that the variables are fairly and normally distributed as indicated by the Jarque-Bera statistics and having a skewness around -1 and 1 is considered symmetric as well as Kurtosis around 3.0.

The average number of M&As executed by the firms is 0.5%, while the minimum (0.00) and maximum (1.00) do not indicate a widespread of mergers and acquisitions transactions executed by firms in the emerging economies. The percentage of the firms' working capital as a share of the various factors driving M&As they undertake shows an average value of 6.992% which is greater than the average number of M&As they undertake. The standard deviation is about 2.6%, suggesting that on average, working capital positions of the firms as a share of factors driving M&As in the emerging markets deviate from the mean by about 2.6%. The working capital (WC) shows huge disparities with the minimum been 0.00 compared to 13.2% as the maximum. The sizes of the firms have been very wide-ranging from a minimum of (3.104) to a maximum of (15.85) with a mean of 6.992. This implies that the acquirers are of various sizes. Financial leverage, which measures the degree to which the firms use fixed -income securities such as debt and preferred equity to acquire assets is quite high, with a minimum of 4% and maximum of around 237% with a mean of about 83%. This suggests that most of these acquirer firms are likely financing their M&As transaction with debt and are saddled with the payment of high interest which will adversely have effect on the bottom-line earnings per share. The ROAs also shows a minimum value of around 2.1% and maximum of 3.87% with a mean of 1.8%. This gives an indication of low returns on the assets of emerging market acquirers. With regard to Tobin Q which measures growth opportunities of these firms the difference between the maximum which is around 2.353 and the minimum of 0.458 is not that huge, suggesting some relatively similar growth rate opportunities for these firms.

Table 2 shows the correlation matrix. The study observes that a negative relationship exists between working capital and M&As executions. Regarding the explanatory variables of total assets, FIN (financial leverage) and ROAs (returns on assets), they are positively correlated with M&As. TQ (Tobin Q)

is negatively related to M&As. The correlation table also provides evidence of a negative correlation between returns on assets on one side and working capital and the total assets on another. Analysis of the data shows Tobin Q having a negative relationship with both total assets and working capital. A further inspection of table reveals a positive relationship between Tobin Q and returns on assets while financial leverage, on the other hand, portrays a negative relationship with both Tobin q and ROAs.

TABLE 1: SUMMARY STATISTICS

	MA	TSSETS	WC	ROA	FIN	TQ
Mean	0.500	9.392	6.992	1.826	0.829	0.459
Maximum	1.000	15.849	13.209	3.865	2.376	2.354
Minimum	0.000	3.104	0.000	-2.110	0.042	-0.688
Std. Dev.	0.501	2.410	2.599	0.891	0.441	0.557
Skewness	0.000	0.296	0.144	-1.100	0.868	0.788
Kurtosis	1.000	2.632	2.666	5.386	3.763	3.417
Jarque-Bera	53.667	6.5295	2.607	128.628	47.597	34.109
Observations	322	322	321	293	318	308

Source: Own calculations, 2018 based on data collected.

TABLE 2: CORRELATION ANALYSIS

	MA	TASSETS	WC	ROA	FIN	TQ
MA	1.0000					
TASSETS	0.0956	1.0000				
WC	-0.0196	0.8408	1.0000			
ROA	0.0003	-0.1433	-0.0473	1.0000		
FIN	0.0688	0.2552	0.1173	-0.2957	1.0000	
TQ	-0.0979	-0.0668	-0.0322	0.3989	-0.1155	1.0000

Source: Own calculations, 2018 based on data collected.

4.2. Diagnostic tests

In terms of validity, this study's results meet the various requirements of the regression models as indicated in Panel B of Table 3. For the multivariate probit cross-sectional regression, the overall fitness of our model is good as indicated by the p-values of 0.3809 and 0.1207 respectively for both the HL test and Andrew test Statistic which are large, showing no evidence of poor fit, but it is good and specified correctly.

In addition, results for heteroscedasticity test confirms no presence of heteroscedasticity as the p-value for this is roughly 0.9494, which gives little evidence against the null hypothesis of homoscedasticity.

4.3. Regression results

4.3.1. Working capital and M&As transactions

The cardinal objective of this study is to investigate whether working capital positions of acquirer firms from the emerging markets drive mergers and acquisitions transactions they execute or not. Financial theory suggests that firms having excess working capital or cash reserves will potentially undertake investments even if those investments have a negative net present value (NPV) or destroy shareholders value.

Our results as set out in Table 3 provide far-reaching revelations and insights. We found the result of the marginal effect coefficient for working capital which is our main independent variable of interest to be significant but negative at 1%. This means that working capital positions of emerging market acquirer firms are less likely to motivate them to undertake M&A transactions compared to other potential factors, all other things being equal. Inspection of Table 3 below shows that a percentage change in these acquirer firms' working capital positions decreases the likelihood of it to influence them to execute M&A transactions by 7.58 percent. This result fails to confirm hypothesis (H1) of this present study that, emerging market acquirer firms' working capital positions are more likely to influence them to undertake M&As. The meaning of the negative sign carried by the acquirers' working capital marginal effect coefficient is that an increase in the levels of these acquirers' working capital positions dampens their appetite to undertake M&A transactions, all other things being equal. In other words, it does not encourage or induce them to engage in acquisition transactions.

The reason for this could be that, as the literature suggests, several emerging market firms are smaller in sizes compared to their counterparts in developed market and usually have limited access to capital markets and mostly depend on their limited internal resources, trade credits and short-term bank loans to make investments in account receivable and inventories which could be used for investment projects such as M&As (Chittenden, Poutziouris & Michaelas 1998). Another reason for the negative sign could be that, emerging market acquirer firms may have more current liabilities making their working capital very low and consequently serve as a demotivating factor for engaging in M&As compared to their peers in developed markets who are persistently being accused

of having excess working capital, where some of them are even reported to be reserving cash in anticipation of M&A activities. A further reason could be that proper management of working capital is yet to gain the needed attention from the management of most emerging market firms. Thus, management of firms in emerging markets considers working capital less in their daily decision-making which accounts for the less likelihood of it to influence them to undertake M&A transactions. In addition, these acquirer firms may also have the majority of the components of working capital to be non-cash, in the form of inventory, trade receivables, prepayments among others. Thus, the attention of management on non-cash items may be low and so are not considered in their decisions regarding the execution of M&As.

Moreover, the negative relationship between the acquirer firms' working capital positions and their desire for M&As is also contrary to the predictions of the liquidity hypothesis, which holds that when corporate liquidity or working capital increases, it improves firms' ability to execute acquisitions, since it can be directly used as a means of payment or can be used to pay for interest on debt finance. The negative sign of the working capital coefficient, however, suggests a contrary relationship between emerging market acquirers' liquidity or working capital positions and M&As. This result is inconsistent with the findings of Opler *et al.* (1999) and Harford (1999) for firms in the United States of America, suggesting that, firms with higher cash holdings or reserves are more likely to undertake acquisitions than their peers who are poor or deficient in terms of cash (illiquid). The result again contradicts the views of Iyer and Miller (2008) and Kayo *et al.* (2010) that managers of firms that have a large amount of excess cash reserves, low financial leverage and high current ratio (CR) may be encouraged to make use of these available resources to finance investment projects including even those with negative NPV for the purposes of empire building.

Further, our result is contrary to the predictions of Chance (2015), KPMG (2016) and Sagner (2007) that the availability of large cash reserves in the form of working capital on balance sheets of firms would be one of the key factors that will drive future M&As. This result, however, suggests otherwise and that other factors may be responsible for driving firms including those from the emerging markets into acquisitions deals. The implication of this finding to managers of emerging market firms is that, since this study has identified firms' working capital positions to be less likely to influence them to undertake acquisition deals, it is essential for firms that are cash-rich or have excess working capital

to look out for other motivating factors that might encourage them to expand their activities through M&A route and never rush into merger deals, but in line with working capital management theory find better and efficient ways to utilise their liquid assets properly to realise more profits for their respective firms. Policymakers should note that, in a competitive world, efficient working capital management is important for all firm sizes operating in any part of the world (Akbar, 2014). Therefore, proper working capital management practices should be a relevant factor that should be considered by firms operating in the emerging markets.

TABLE 3: PROBIT MARGINAL EFFECTS RESULTS ON WHETHER WORKING CAPITAL DRIVES M&AS TRANSACTIONS

Panel A: Regression Results			
DEPENDENT VARIABLE:(M&A) EXPLANATORY VARIABLES;	PROBIT REGRESSION COEFFICIENTS	PROBIT MARGINAL EFFECTS AT MEAN	STANDARD ERROR
<i>LTASSETS</i>	0.2255***	0.0898***	0.0674
<i>LWC</i>	-0.1904***	-0.0758***	0.0613
<i>ROA</i>	0.1423*	0.0566*	0.0980
<i>FIN</i>	0.0828*	0.0329*	0.1945
<i>TOBIN'S Q</i>	-0.2708**	-0.1078**	0.1479
Constant	-0.9230***	-0.3673***	0.4169

Panel B: Diagnostic Tests			
H-L Statistic	8.5587	Prob. Chi-Sq (8)	0.3809
Andrew Statistic	15.3231	Prob. Chi-Sq (10)	0.1207
Test for Heteroscedasticity LM test = 0.0040 P Value = 0.9494			

Source: Author's Estimation, 2018, based on data collected.

Note: The table shows probit regression coefficients and their marginal effects on whether working capital drives M&As transactions or not. *, ** and *** represent 10%, 5% and 1% significance level respectively.

On the effects of the control variables on M&A executions, the result provides evidence of a marginal effect coefficient that is positive and significant at 1% for the acquirers' total assets (proxy for firms' sizes). This gives an indication that a percentage increase in the sizes of these acquirer firms is more likely to influence these acquirers to engage in acquisition transactions, all other things being equal. Further, an inspection of Table 3 shows that total assets representing sizes of emerging market acquirers are 8.98% more likely to drive

M&A transactions these firms undertake. The meaning of the positive sign carried by the total assets' coefficient is that improvement in the sizes of these acquirer firms provides enough benchmark or source of motivation for them to undertake investment projects such as M&As for the purposes of growth and expansion. The reason could be that, since several firms in the emerging markets appear smaller in terms of their sizes compared to their counterparts in the developed markets (Akbar, 2014), firms in emerging markets make conscious efforts to invest more in their total assets for it to serve as springboard for them in transacting future investment activities.

Additionally, the highly significant positive relationship between the acquirer firms' sizes and M&A executions could also be explained to be in line with financial theory which suggests that, as firms expand in size through an increase in assets, they tend to invest more in different areas including M&As. So, as a policy measure, managers of emerging market firms should take keen interest in putting measures in place to grow the assets base of their firms since they may serve as a motivating factor in making investment decisions such as those relating to acquisitions. A further suggestion based on this result is that, consistent with the total asset management theory which talks about the acquisition, use, disposal and management of assets of a company properly in order to maximise profit, it is important for managers or policymakers and boards of companies to establish policies that will guide and regulate how emerging market managers utilise assets of their firms. The overriding consideration should be to invest firms' assets in projects with high possibility of yielding or providing positive returns to firms. The reason is that the findings of this study clearly demonstrate that firms' total assets have an impact on firms' investment decisions and therefore proper management of them may contribute positively to creating more value for firms to benefit shareholders ultimately.

The marginal effect coefficient for growth opportunities as measured by the acquirers' Tobin's q is negative and statistically significant at 5%, implying that, emerging market firms' expectations for growth and expansion is less likely to influence them to pursue M&A deals. Table 3 above indicates that any additional improvement in the acquirer firms' ability to grow or expand is about 11% less likely to influence these firms to execute M&A transactions. The explanation of the negative sign carried by Tobin's q coefficient which is a proxy for the acquirers' growth opportunities is that emerging market acquirers strategically may not want to grow and expand their businesses both domestically and internationally using the M&A route. This may be due to the fact that several

of them appear not to have gained the necessary exposures and experiences for the execution of internationalisation strategy such M&As as literature suggests (Li, 1994; Chang, 1995). Further, the negative sign possessed by the Tobin's q coefficient appears contrary to theoretical expectations of the strategic realignment of changing environment hypothesis, which suggests that, generally, when the opportunity and ability for firms' growth within a short period of time such as M&As are available to firms, slow organic growth strategies are not considered to be the best alternatives. This result, however, appears consistent with Margsiri *et al.* (2008)'s view that, when a firm's operating capacity is high, it is not important for it to depend on external investments such as acquisitions to grow and expand because expansion through M&As actually will potentially make the acquirer firm end up paying more not only for the assets acquired but also expenses on integration. Despite its consistency with the assertion of Margsiri *et al.* (2008), the result broadly runs contrary to findings of other previous studies like Thanos and Papadakis (2012), who suggest that firms have popularly adopted growth through M&As to achieve corporate growth and other corporate objectives.

Further, it is inconsistent with the theory of market for corporate control which suggests that, in an efficient market, companies that are not performing well are more likely to become targets and have their assets transferred to some more capable hands unless they are able to acquire assets to improve on the level of their profitability. The inference, therefore, is that financially strong and healthy companies are more likely to be active acquirers while the underperforming ones would be potential targets. Therefore, it is important for managers of emerging market firms not to limit their growth and expansion strategies to only internal processes where growth is achieved from within their own internal resources but consider other inorganic and fast growth strategies like M&As which have the potential to give them the necessary exposures and experiences to become global brands.

The marginal effect coefficient for returns on assets (ROAs) of the acquirers was found to be positive but statistically significant at 10%, indicating that ROAs of emerging market acquirers are more likely to play a role in motivating the acquirers to embark on M&A deals. However, the weakly significant positive relationship between the acquirers ROAs and their appetite for M&As could suggest that the firms' ROAs do not substantially contribute to influencing them to undertake M&As compared to other motivating factors. The meaning of the positive sign carried by the ROAs coefficient is that, as the ROAs of these firms

go up, their desire to pursue acquisition deals also go up which could impact positively on these firms' performances, especially on their profit (ROAs) levels. This positive relationship between the ROAs of the acquirers' and execution of M&As could also mean that an improvement in the firms' performances (in terms of increases in returns on their assets) gives them an indication that they can adopt M&As as a strategy for value creation in terms of growth, expansion and improvement in profitability levels. Thus, they may consider M&As as a way to achieve synergistic and wealth effects to enhance shareholders value. This means that, the positive relationship between their ROAs and M&As makes these emerging market firms become interested in adopting M&As as a reliable growth strategy for realising more profits on their investments, a view which is similar to suggestions by Arikian and Stulz (2016), Leepsa and Misha (2012) and DeYoung, Evanoff and Molyneux (2009).

A further explanation of the positive relationship between the acquirers ROAs and their desire for M&As could be advanced from the perspective of managerial over-confidence motive. Here, managers of these acquirer firms who increase their ROAs become over-confident and feel so good that they can handle anything and by making their companies big, they would be able to handle them and therefore become motivated to acquire other firms. This appears consistent with the theoretical expectations of market for corporate control which holds that, firms that are not doing well in an efficient market would either have to increase their profitability levels (ROAs) through the acquisition of more assets or risk becoming targets by transferring their resources to another firm that is more capable to manage it better. This result further supports Boubakri and Cosset (1998)'s assertion that firms with higher returns on their assets would be in a better position to raise money in the financial markets, for investments including M&As. Based on this result, the possible suggestion to emerging market managers could be that they ought to be aware of the fact that, the positive returns they may derive on their assets through internal or organic growth processes will not be a sufficient basis to motivate them to pursue M&As. Therefore, it is important for them to pay attention to other more likely influencing factors for M&A executions such as their total assets among others. Albeit, ROAs of firms can still provide them with a platform to evaluate the performance of their businesses and decide whether it can be relied upon to make decisions regarding M&As executions or not.

Our results also show that the marginal effect coefficient for financial leverage is positive but insignificant indicating that financial leverage does not play any

role in driving acquisition transactions by acquirer firms from the emerging markets.

4.3.2. *Diagnostic tests*

Our results in terms of validity, meet the various requirements of regression models revealed in Panel B of Table 4 below. For the probit cross-sectional regression, the overall fitness of our model is good as indicated by the p-values of 0.811 and 0.642 respectively for both the HL test and Andrew test Statistic which are large, giving an indication that, there is no evidence of poor fit, rather, showing that, the model is specific correctly. As well, results for the heteroskedasticity test give support to no presence of heteroskedasticity as the p-value for this is roughly 0.6740, which gives little evidence against the null hypothesis of homoscedasticity.

4.3.3. *Working capital and types of M&As transactions*

From Table 4 below, the study finds the marginal effect coefficient for working capital, our main explanatory variable for this present study to be negative and statistically significant at 1%, suggesting that, working capital positions of emerging market acquirers are less likely to influence them to undertake either horizontal or vertical type of merger. Inspection of Table 4 reveals that a percentage change in these firms' working capital positions decreases the likelihood of it to influence them to execute either horizontal or vertical type of merger during M&As transactions by 8.3 percent. This suggests that other factors other than working capital might motivate them to engage in either a horizontal or vertical type of M&As deals. This result fails to confirm our earlier prediction that, the working capital positions of emerging market acquirer firms are more likely to influence them to pursue either horizontal or vertical type of merger deal, therefore, we reject hypothesis (H2) of this study. What the negative sign carried by the working capital coefficient means is that an increase in the acquirer firms' working capital positions reduces the influence it can have on their decisions to undertake either a horizontal or vertical type of merger. The negative sign could also mean that, even if emerging market firms consider M&As as a reliable firms' growth strategy, their desire to explore either a horizontal or vertical type of merger will not be dependent on their working capital positions. The reason may be that, managers of these firms being aware of the various advantages inherent in diversification through the various types of mergers, would not focus or limit their interest of achieving growth and expansion for their firms on pursuing a particular type of merger deal but broaden their interest to include

all the types of mergers in order to derive the associated benefits each of them provides. For instance, for these acquirers to gain financial synergies, they may decide to diversify through conglomerate mergers. Those that are also interested in increasing market power can pursue horizontal mergers in order to benefit from monopolistic synergies this type of merger offers. Others who desire to execute M&As for the purposes of efficiency gains can derive this operational synergy through vertical mergers.

This finding for the study, however, does not seem to support suggestions in the literature that, acquirers stand to benefit from efficiency gains associated with vertical acquisitions and also realise monopolistic synergies through an increase in market power in horizontal mergers. It rather appears consistent with the suggestion by Dringoli (2016) that, even though decreasing working capital by firms is one of the ways to achieve economies of scale in horizontal or vertical types of mergers, it does not influence firms to decide on the type of M&A transactions they should pursue. The managerial implication of this result to managers in the emerging markets could be that their firms' working capital positions may not be a reliable factor that would encourage them to execute either horizontal or vertical mergers. Therefore, for them to be able to enjoy the numerous advantages these types of mergers offer such as creation of synergies, reduction of risk, increasing of a firm's bargaining power over suppliers and buyers, strengthening of competitive position or cost of a firm's original business (Hill & Jones, 2004) to firms, more efforts must be made to identify potential drivers of these merger types.

Regarding the effects of the control variables on the type of merger transactions acquirers from the emerging market undertake, the marginal effect coefficient for total assets which represents the firms' sizes is positive and significant, indicating that the sizes of these acquirers are more likely to influence them to pursue either a horizontal or vertical type of merger. From Table 4, it can be observed that any additional improvement in a firm's size (as reflected in the firm's total assets) is more likely to influence the type of merger deal it will undertake by about 11%. The explanation for the positive sign possessed by the marginal effect coefficient for total assets is that, as the firms' sizes increase, their decision to pursue more of either a horizontal or vertical type of merger also goes up. This seems to be what we observe in reality for acquirer firms from the emerging markets and the reasons for this could be the following;

TABLE 4: PROBIT MARGINAL EFFECTS RESULTS ON THE TYPE OF M&A TRANSACTIONS EMERGING MARKET ACQUIRERS PURSUE

Panel A: Regression Results			
DEPENDENT VARIABLE: (MERGER TYPE)	PROBIT REGRESSION COEFFICIENTS	PROBIT MARGINAL EFFECTS AT MEAN	STANDARD ERROR
EXPLANATORY VARIABLES;			
<i>LTASSETS</i>	0.3049***	0.1091***	0.0688
<i>LWC</i>	-0.2332***	-0.0835***	0.0620
<i>ROA</i>	0.1930*	0.0691*	0.1108
<i>FIN</i>	-0.0936	-0.0335	0.2086
<i>TOBIN'S Q</i>	-0.0987	-0.0353	0.1559
Constant	-0.9424	-0.6952	0.4518
Panel B: Diagnostic Tests			
	H-L Statistic 4.4876	Prob. Chi-Sq (8) 0.8107	
	Andrew Statistic 7.8678	Prob. Chi-Sq (10) 0.642	
	Test for Heteroscedasticity LM test 0.1769 = P Value = 0.6740		

Source: Author's Estimation, 2018, based on data collected.

Note: The table shows probit regression coefficients and their marginal effects on the type of M&As emerging market acquirers pursue. *, ** and *** represent 10%, 5% and 1% significance respectively.

One, as these emerging market acquirers improve in sizes, those that desire synergistic gains in terms of increased market share or power, cost savings and explore new market opportunities may become interested in horizontal mergers and acquire target firms with similar characteristics who will be less difficult to integrate with and also readily provide them with the needed synergies usually associated with horizontal mergers as the diversification hypothesis suggests (Hoffmann, 2008; Chatterjee, 1986).

Two, other emerging market acquirers who want to have control over sources of raw materials for their business activities may pursue vertical mergers in order to reduce operational costs and also reduce costs by expanding economies of scale. This finding broadly appears consistent with Anju (1990)'s position that related acquisitions in the form of horizontal or vertical type of mergers primarily provide synergistic benefits to acquirer firms that pursue large relative size of target firms. This means that managers need to conduct careful analysis

on the type of merger deal they execute relative to their firms' sizes in order to achieve synergistic gains and increasing cash flows from acquisitions in the form of either increased revenues or reduction in costs.

The ROAs of the firms also have their marginal effect coefficient to be positive and statistically significant at 10%, suggesting that they have some level of influence on the acquirers' decisions regarding the type of M&A transactions they pursue albeit not substantial. Table 4 shows that any percentage change in the value of the firms' assets is only 6% more likely to influence these acquirers to pursue either a horizontal or vertical type of mergers. The possible explanation of the positive sign for the ROAs coefficient could be that an increase in the firms' profit levels as reflected in their respective ROAs to a lesser extent has the potential to influence them to undertake investment activities such as M&As. This result is in line with the empirical finding of Singh and Montgomery (1987) that, there is a total dollar gain (in terms of returns to the firm's assets used) in related acquisitions such as horizontal and vertical mergers compared to unrelated acquisitions, and that, acquired firms in related acquisitions, derive more significant benefits than their peers in unrelated acquisitions. The implications for managers of emerging market firms are that a potential target firm stands to benefit more from an acquisition involving a related acquirer firm than an unrelated acquirer. This implication supports the idea that the market cherishes combinations of firms that will result in synergistic gains. As a result, managers may be encouraged to scrutinise the potential returns to be derived from related and unrelated acquisitions when pursuing M&A transactions, although acquisitions involving related product market yield higher total returns. Gongming (1997) also adds that the closer the relations between different business activities of a firm, the more likely it is to be profitable, and related acquisitions such as horizontal and vertical mergers are found to outperform unrelated ones in the case of high global diversification.

For financial leverage, its marginal effect coefficient is negative and insignificant, meaning leverage levels of emerging market acquirers do not in any way affect their investment decisions with respect to the type of M&As they undertake.

For the acquirers' opportunities for growth as measured by their Tobin's q, the marginal effect coefficient is also negative and insignificant. This means that the type of merger deals acquirers from the emerging markets will pursue are not influenced by their individual growth prospects.

5. Conclusion and recommendations

Our results indicated that emerging market acquirers working capital positions are less likely to drive them into executing M&A transactions. However, their sizes (as proxied by their total assets) have a positive relationship on acquisition transactions they pursue, suggesting therefore that, these acquirer firms' sizes are more likely to influence them to undertake M&A deals. In view of this, as a policy measure, managers of emerging market firms should take a keen interest in putting measures in place to grow the assets base of their respective firms since they may serve as a motivating factor in taking investment decisions such as those relating to acquisitions. Regarding the influence of the firms' working capital positions on the type of M&As deals they pursue, the results indicate that it is also less likely to influence these acquirer firms' decisions on particular M&A deal they become interested in (that is, horizontal, vertical and conglomerate).

Based on the findings of this study, we recommend that, even though working capital positions of acquirer firms from the emerging markets are less likely to influence their investment decisions particularly M&A transactions, managers should not ignore to manage their working capital positions well. They should institute proper working capital management practices in their companies, in order not to experience liquidity challenges of either excess or shortages, since any of them could affect the smooth running of their business operations especially in the short-term period. Second, managers should make a conscious effort in growing their total assets base and help improve returns on their assets to ensure sustainability in profits, because they have the potential to influence their investments decisions such as M&As.

Biographical notes

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