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Political affinity and investors' response to the acquisition premium in cross-border M&A transactions — A moderation analysis

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Abstract

This article investigates the moderating effect of political affinity between countries on investors' reactions to the premium in cross-border acquisitions (CBAs). Based on a sample of 1,183 CBAs between 1999 and 2018, we find that political affinity positively moderates the relationship between the acquisition premium and the acquiring and target firms' stock market return. We argue that investors use political affinity to assess the reliability of the premium (i.e., management's overall perception of a given deal's synergistic potential). This is in line with prior literature reasoning that, unlike strong political affinity, weak political affinity increases the likelihood of government intervention, decreases the likelihood of deal completion, and results in higher premiums to mitigate the previous effects, thus potentially increasing the likelihood of value destruction.

KEYWORDS

acquisition premium, cross-border mergers and acquisitions, investor reaction, moderation analysis, political affinity

1 | INTRODUCTION

Previous studies on mergers & acquisitions (M&A) announcements have primarily shown negative abnormal returns (i.e., value destruction) for acquirer shareholders (Moeller, Schlingemann, & Stulz, 2004) and positive abnormal returns for target shareholders (Jensen & Ruback, 1983).[1] In this line of research, the premium paid by the acquiring firm has gained considerable attention concerning the explanation of the announcement returns (Hayward & Hambrick, 1997; Moeller, Schlingemann, & Stulz, 2005), as the premium reflects management's overall perception (i.e., expectation) of a given deal's synergistic potential (Hayward & Hambrick, 1997; Laamanen, 2007). The premium is found to be positively related to abnormal returns of the target firm, as it represents a bid price above the market value of the shares (Díaz, Azofra, & Gutiérrez, 2009). Then again, it is negatively related to abnormal returns of the acquiring firm because high premiums may signal potential overpayments (Varaiya & Ferris, 1987).

As management has informational advantages over investors, the latter must assess the reliability of the information provided by the former (Zhang & Wiersema, 2009). This is all the more relevant as in many cases, acquisitions destroy acquirer value (King, Dalton, Daily, & Covin, 2004). The premium, representing information on management's overall perception of a given deal's synergistic potential, is therefore evaluated by investors in terms of its credibility based on additional public information. In this vein, Schijven and Hitt (2012) show that investors use factors such as industry similarity, payment method, and acquirer performance to assess the reliability of management's perception. As we posit that cross-border acquisitions (CBAs) are comparatively complex organizational events (i.e., in contrast to domestic acquisitions), the central aim of our article is to deepen the understanding of what information investors use in this type of acquisition to assess the reliability of the acquisition premium. Similar to Schijven and Hitt (2012), we choose a moderation analysis to address this.

We hypothesize that political affinity — reflecting the similarity of national interests in global affairs — between acquirer and target firm countries moderates the relationship between the premium and abnormal announcement returns in CBAs. Our results show that political affinity, measured as similarity in voting behavior in the UN General Assembly (Gartzke, 1998), positively moderates the relationship between acquisition premium and announcement returns. Specifically, we find that target shareholders' reaction to the acquisition premium is more positive (higher positive cumulative abnormal returns) when political affinity between acquirer and target countries is strong. As previous studies show that weak political affinity increases the likelihood of government intervention (Bertrand, Betschinger, & Settles, 2016) and thus decreases the likelihood of deal completion (Zhang & He, 2014), our results may be viewed as empirical evidence that political affinity moderates target investors' reaction due to the perceived risk of government intervention.[2] Furthermore, we find that the acquirer shareholders'

[1]That said, a few studies find the opposite. For instance, McCarthy, Dolfsma, and Weitzel (2016) identify positive abnormal returns for Chinese overseas acquisitions. Shapiro and Li (2016) attribute this positive outcome to country-level heterogeneity (i.e., differences in political/cultural characteristics as well as formal and informal institutions). Then again, Young (2016) argues the positive reaction may also be at least partly a result of Chinese investors' optimistic view regardless of the mergers' prospects for success.

[2]We acknowledge that there are also government interventions in favor of the acquisition, although perhaps less common.

reaction to the acquisition premium is weaker (less negative cumulative abnormal returns) when political affinity is strong.[3] Previous studies show that foreign acquirers must ensure that the offer price is high enough for the target not to resist the bid (Graham & Marchick, 2006) and to reduce the potential risk of government intervention (Bertrand et al., 2016) especially when political affinity is weak. Therefore, our results may be viewed as empirical evidence that political affinity moderates acquirer investors' reactions to the perceived risk of overpayment (and therefore value destruction).

We thus contribute to the literature on the behavioral dimension of investor reactions to acquisition announcements. Specifically, we extend Schijven and Hitt (2012) in providing empirical evidence that in CBAs, with an arguably more complex information setting than in domestic acquisitions, investors incorporate political affinity when assessing the reliability of management's perception of a given deal's synergistic potential. Our results suggest that management may to some extent be able to manage investor reactions by disclosing sufficiently detailed information to augment the salient but often crude signals that are available to investors (particularly in CBAs with additional complexity arising from bilateral political affairs).

Our article also contributes to an emerging body of work that accounts for heterogeneity in bilateral relations (e.g., Arikan & Shenkar, 2013; Bertrand et al., 2016; Levine, Lin, & Shen, 2020; Li, Arikan, Shenkar, & Arikan, 2020; Li, Meyer, Zhang, & Ding, 2018; Zhang & He, 2014) which has long been neglected in research on CBAs (Li et al., 2020). Prior work has mainly focused on institutional factors (Aybar & Ficici, 2009) and cross-cultural differences (Chakrabarti, Gupta-Mukherjee, & Jayaraman, 2009) to determine the factors underlying CBA value creation, or on country-specific political risk (Dinc & Erel, 2013). In showing that investors incorporate political affinity when assessing the reliability of management's perception of a given deal's synergistic potential, our article is particularly closely related to Bertrand et al. (2016) who show that managers also incorporate political affinity when preparing an offer.

The remainder is structured as follows. In the next section, we develop our hypotheses. Then we present our data, method, and results. We conclude with a discussion of our findings.

2 | HYPOTHESIS DEVELOPMENT

Firms initiate M&A deals above all for one reason: to create value (Xie, Reddy, & Liang, 2017). Value equals the total synergy that the acquisition is expected to yield minus the premium paid by the acquirer (Schijven & Hitt, 2012). From the perspective of the shareholders of the target firm, the acquisition premium captures the magnitude of the bid price being above the shares' market value (Díaz et al., 2009). Therefore, every dollar spent on the premium increases the potential amount of cash in target shareholders' pockets. In line with this argument, Díaz et al. (2009) indeed find a positive relationship between the premium and the abnormal announcement returns of the target firm. However, the likelihood of deal completion critically depends on the likelihood of government intervention in favor of the target. Previous literature has shown that government intervention occurs more often if the acquirer is from a different country than the target firm (Dinc & Erel, 2013) and that the

[3]To get a better grasp of this line of reasoning, let us assume that two CBAs involve (the payment of) an identical premium but differ in terms of political affinity (i.e., strong vs. weak). In this case, we expect target shareholders to react more positively to the premium if political affinity were strong, which we indeed find as an empirical result.

likelihood of government intervention also depends on the political affinity between the acquirer and target countries (Bertrand et al., 2016). Here, political affinity denotes the similarity of national interests in global affairs. Weak political affinity increases the likelihood of political and economic conflict (Dixon & Moon, 1993; Gartzke, 2000). In the context of CBAs, it increases the likelihood of government intervention in favor of the domestic target because firms based in countries that share a political affinity are less likely to be perceived as a threat (Bertrand et al., 2016). We therefore hypothesize that political affinity positively affects the target firm's shareholders' response to the acquisition premium. Formally, we state:

> **Hypothesis (H1).** Political affinity between acquirer and target countries positively moderates the relationship between the acquisition premium and the target firm's stock market return to an acquisition announcement.

From the perspective of the acquiring firm's shareholders, a comparison of the premium and the potential synergy suggests whether value is created or destroyed. Therefore, every dollar spent on the premium increases the likelihood of value destruction, resulting in negative stock returns of the acquiring firm to an acquisition announcement (Schijven & Hitt, 2012). To assess potential value destruction, investors evaluate the credibility of the premium, which represents the information that management discloses on its overall perception of a given deal's synergistic potential. Although prior literature suggests that value creation is the main motive for M&A activities (e.g., Seth, Song, & Pettit, 2000), it also shows that other motives like agency issues (Haleblian, Devers, McNamara, Carpenter, & Davison, 2009), self-interest-seeking behavior (Jensen, 1989), overconfidence (Malmendier & Tate, 2008), or hubris (Hayward & Hambrick, 1997) can influence management's decisions on M&A activities, thus putting into question the unbiasedness of the premium. In CBAs, that unbiasedness is additionally challenged by political affinity: Target firms are more likely able to oppose foreign acquisitions by leveraging government intervention when political affinity is weak. As governments can decide to interfere in the acquisition process either on their initiative or upon request of the target (Bertrand et al., 2016), foreign acquirers must ensure that the offer price is high enough for the target not to resist the bid (Graham & Marchick, 2006). Weak political affinity hence increases the premium and makes it more likely for an acquisition to destroy rather than create value (Haunschild, 1994; Hayward & Hambrick, 1997). We therefore hypothesize that political affinity positively affects the acquiring firm's shareholders' response to the acquisition premium.

> **Hypothesis (H2).** Political affinity between acquirer and target countries positively moderates the relationship between the acquisition premium and the acquiring firm's stock market return to an acquisition announcement.

3 | DATA AND METHODOLOGY

The M&A data are retrieved from Thomson Financial's SDC Platinum database. We collect CBAs that were either completed or withdrawn. We obtain data on stock returns and firm characteristics from CRSP (Center for Research in Security Prices), Compustat, Refinitiv Datastream, and Refinitiv Worldscope. As described in detail in the Appendix S1, this data merge results in a total of 1,183 acquisitions from 1999 to 2018 representing CBAs from 43 unique acquirer countries and 55 unique target countries.

Our dependent variable is cumulated abnormal returns (CARs), which represent the portion of the return that is left unexplained by an economic model. As the purpose of such an economic model in an event study is to isolate the incremental impact of an event (e.g., acquisition announcement) on securities price performance, recent literature uses multifactor models to estimate abnormal returns. Multifactor models are better able to distinguish the event from known determinants of stock price performance than the market model (Kothari & Warner, 2007), which is widely used in earlier event studies. We use all six factors (market, size, book-to-market, momentum, investment, and operating profitability-based factors) from the factor models of Carhart (1997) as well as Fama and French (2015) to determine abnormal returns. All factors are retrieved from Kenneth R. French's website.[4] The estimation window runs from 210 to 11 days before the event to ensure a sufficient estimation period and a gap between estimation and event window (Moeller et al., 2004). As our dependent variable, we use the CARs from 1 day before to 1 day after the announcement, with the announcement day being the focal day (Li et al., 2020).

Our first independent variable of interest is the initial acquisition premium. We follow Haunschild (1994), Dinc and Erel (2013), and Bertrand et al. (2016) and use the ratio of the initial offer price over the closing stock price 4 weeks before the announcement. Based on the findings from previous studies, Bertrand et al. (2016) recommend using a 4-week period since information could leak earlier and distort the effect. Our second independent main variable of interest is political affinity. We follow prior literature (Bertrand et al., 2016; Gartzke, 1998; Li et al., 2020) and determine political affinity by the voting behavior between two countries in the UN General Assembly. The data used to calculate political affinity are provided by Voeten, Strezhnev, and Bailey (2009). Building on the measure of Bertrand et al. (2016), we create a continuous variable (political affinity C) that ranges between zero and one. A value of one (zero) represents completely consistent (opposite) voting behavior between two countries in the UN General Assembly and thus strong (weak) political affinity. While the relationship between the United States and the United Kingdom is an example of strong political affinity, the relationship between the United States and China is an example of weak political affinity.[5] As a second measure of political affinity, we create a time-varying dummy (political affinity D) which is one if the identical voting behavior of two nations dominates opposite voting behavior (strong political affinity) and zero otherwise (weak political affinity). As dichotomization provides us with a more conservative approximation of political affinity, it allows us to investigate whether our results critically depend on the variable construction. Based on prior research we employ a vast variety of control variables, which can be divided into two subsets: deal- and firm-level characteristics. Deal-level controls include a tender offer dummy (Rossi & Volpin, 2004), a hostile takeover dummy (Bertrand et al., 2016), a poison pill dummy (Schwert, 2000), a stock payment dummy (Shleifer & Vishny, 2003), a competing offer dummy (Walkling & Edmister, 1985), a dummy indicating whether the acquirer and target are in the same SIC industry,[6] as well as the

[4]http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library.html.

[5]Recent political tensions between the United States and China and related disagreements on bilateral and multilateral political issues highlight how political affinity may affect CBAs; a case in point is the attempted acquisition of the Chinese firm TikTok by the U.S. firm Microsoft (https://www.nytimes.com/2020/08/26/technology/tiktoks-microsoft-deal-soap-opera-trump.html?auth=login-facebook) or the (blocked) Chinese firm Beijing Shiji Information Technology's acquisition of the U.S. target firm StayNTouch (https://www.nytimes.com/2020/03/06/business/economy/trump-administration-blocks-chinese-acquisition-cfius.html).

[6]To identify whether the acquirer and target are in the same SIC industry, we use the SIC2 industry classification following Cao, Li, and Liu (2019).

TABLE 1 Univariate statistics

	Weak political affinity		Strong political affinity		Weak vs. strong political affinity	
	Mean	***SD***	**Mean**	***SD***	**Diff.**	***p* value**
Acquirer CAR	−0.008	0.075	0.003	0.075	−0.011	.091
Target CAR	0.259	0.454	0.226	0.261	0.032	.200
Acquisition premium	0.407	0.402	0.418	0.421	−0.011	.761
Tender offer	0.410	0.493	0.441	0.497	−0.031	.470
Hostile offer	0.026	0.159	0.030	0.171	−0.005	.755
Poison pill	0.019	0.138	0.011	0.103	0.009	.360
Stock payment	0.064	0.246	0.197	0.398	−0.133	.000
Competing bidder	0.045	0.208	0.100	0.301	−0.055	.026
Same industry	0.603	0.491	0.633	0.482	−0.030	.465
Relative size	0.303	1.790	0.320	2.474	−0.017	.934
Target size	12.617	1.796	12.802	2.103	−0.184	.299
Target Tobin's *Q*	2.424	3.515	1.883	2.770	0.541	.029
Target leverage	0.134	0.173	0.198	0.206	−0.064	.000
Target profitability	0.082	0.196	0.039	0.230	0.043	.028
Acquirer size	15.568	2.255	15.466	2.262	0.101	.601
Acquirer Tobin's *Q*	1.671	1.228	1.432	1.419	0.240	.046
Acquirer leverage	0.227	0.163	0.247	0.172	−0.020	.181
Acquirer profitability	0.094	0.177	0.088	0.144	0.007	.604

relative size of target and acquirer (Jarrell & Poulsen, 1989). Regarding acquirer and target firm characteristics, we control for size (Erel, Liao, & Weisbach, 2012), Tobin's *Q* (Moeller et al., 2005), leverage (Maloney, McCormick, & Mitchell, 1993), and profitability[7] (Bertrand et al., 2016). In addition to these two sets of control variables, we employ year, country,[8] and industry fixed effects. The latter is based on the Fama and French (1997) 48 industry classifications.

Table 1 provides descriptive statistics on the above variables from our 1,183 acquisition events separately based on the value of the political affinity dummy of an event (i.e., weak vs. strong political affinity). The cumulative abnormal returns of the acquirers are higher when political affinity is strong ($p = .091$). We find that acquirers and targets exhibit higher Tobin's *Q* values when political affinity is weak ($p = .046$ and .029, respectively). This implies that primarily valuable firms accept the risk associated with these acquisitions and only valuable firms are acquired, in turn indicating that less valuable firms neither accept these risks nor are worth taking the risk. Political affinity also

[7]We follow Bertrand et al. (2016) and measure profitability as EBITDA over total assets.

[8]With country fixed effects (acquirer [target] country fixed effects when the dependent variable is the acquirer [target] CARs), we implicitly also capture intervention likelihood to some extent. Yet as the intervention likelihood for a specific country could also change over time, we additionally control for the intervention likelihood of the target's firm country (both target's and acquirer's country to be even more conservative). Our main results continue to hold.

TABLE 2 The moderating effect of political affinity on investors' response to acquisition premiums: Multivariate results

		Target CAR		Acquirer CAR		Target CAR		Acquirer CAR	
Dependent variable		**(1)**	**(2)**	**(3)**	**(4)**	**(5)**	**(6)**	**(7)**	**(8)**
Premium		0.216	−0.032	−0.007	−0.036	0.216	−0.604	−0.007	−0.110
		(0.056)	(0.155)	(0.007)	(0.020)	(0.061)	(0.439)	(0.007)	(0.064)
		[0.000]	[0.837]	[0.303]	[0.066]	[0.000]	[0.169]	[0.292]	[0.085]
Political affinity *D*		−0.003	−0.125	0.009	−0.005				
		(0.027)	(0.078)	(0.007)	(0.007)				
		[0.926]	[0.110]	[0.164]	[0.505]				
Premium × Political affinity D	(H1/H2)		0.283		0.033				
			(0.149)		(0.018)				
			[0.058]		[0.072]				
Political affinity C						0.000	−0.386	0.011	−0.035
						(0.109)	(0.252)	(0.025)	(0.026)
						[0.997]	[0.126]	[0.676]	[0.173]
Premium × political affinity C	(H1/H2)						0.932		0.117
							(0.485)		(0.068)
							[0.055]		[0.086]
Tender offer		0.015	0.018	0.010	0.011	0.015	0.017	0.011	0.011
		(0.017)	(0.016)	(0.004)	(0.004)	(0.017)	(0.016)	(0.005)	(0.005)
		[0.386]	[0.268]	[0.012]	[0.012]	[0.377]	[0.309]	[0.019]	[0.018]
Hostile offer		0.044	0.039	0.001	0.000	0.044	0.039	0.001	0.001
		(0.034)	(0.036)	(0.012)	(0.012)	(0.031)	(0.032)	(0.011)	(0.011)
		[0.201]	[0.273]	[0.945]	[0.987]	[0.155]	[0.214]	[0.916]	[0.938]
Poison pill		−0.012	−0.006	−0.023	−0.023	−0.012	−0.002	−0.024	−0.023
		(0.049)	(0.054)	(0.014)	(0.014)	(0.057)	(0.058)	(0.016)	(0.016)
		[0.811]	[0.917]	[0.088]	[0.106]	[0.838]	[0.971]	[0.128]	[0.150]

TABLE 2 (Continued)

	Target CAR		Acquirer CAR		Target CAR		Acquirer CAR	
Dependent variable	**(1)**	**(2)**	**(3)**	**(4)**	**(5)**	**(6)**	**(7)**	**(8)**
Stock payment	−0.078	−0.074	−0.015	−0.014	−0.078	−0.076	−0.014	−0.014
	(0.044)	(0.044)	(0.009)	(0.009)	(0.036)	(0.035)	(0.008)	(0.008)
	[0.081]	[0.092]	[0.096]	[0.107]	[0.031]	[0.031]	[0.085]	[0.093]
Competing bidder	−0.085	−0.082	−0.008	−0.008	−0.086	−0.084	−0.007	−0.007
	(0.024)	(0.025)	(0.006)	(0.006)	(0.025)	(0.025)	(0.006)	(0.006)
	[0.001]	[0.001]	[0.180]	[0.194]	[0.001]	[0.001]	[0.229]	[0.242]
Same industry	−0.017	−0.017	0.006	0.006	−0.017	−0.016	0.006	0.006
	(0.016)	(0.017)	(0.004)	(0.004)	(0.018)	(0.017)	(0.005)	(0.005)
	[0.284]	[0.303]	[0.193]	[0.174]	[0.329]	[0.347]	[0.206]	[0.173]
Relative size	0.001	0.002	0.007	0.007	0.001	0.002	0.007	0.007
	(0.003)	(0.002)	(0.003)	(0.003)	(0.003)	(0.002)	(0.003)	(0.003)
	[0.621]	[0.164]	[0.008]	[0.006]	[0.591]	[0.238]	[0.008]	[0.005]
Target size	−0.007	−0.006	−0.002	−0.002	−0.007	−0.007	−0.002	−0.002
	(0.006)	(0.006)	(0.002)	(0.002)	(0.005)	(0.006)	(0.002)	(0.002)
	[0.240]	[0.286]	[0.186]	[0.186]	[0.183]	[0.243]	[0.192]	[0.184]
Target Tobin's *Q*	−0.001	−0.001	0.000	0.000	−0.001	−0.001	0.000	0.000
	(0.003)	(0.004)	(0.001)	(0.001)	(0.003)	(0.003)	(0.001)	(0.001)
	[0.808]	[0.767]	[0.648]	[0.654]	[0.794]	[0.719]	[0.578]	[0.618]
Target leverage	−0.021	−0.021	0.003	0.004	−0.022	−0.029	0.004	0.004
	(0.038)	(0.040)	(0.011)	(0.011)	(0.038)	(0.039)	(0.011)	(0.011)
	[0.575]	[0.606]	[0.754]	[0.687]	[0.572]	[0.462]	[0.721]	[0.708]
Target profitability	−0.170	−0.162	−0.002	−0.001	−0.170	−0.169	−0.003	−0.002
	(0.084)	(0.077)	(0.011)	(0.011)	(0.082)	(0.079)	(0.012)	(0.011)
	[0.043]	[0.036]	[0.851]	[0.946]	[0.039]	[0.033]	[0.819]	[0.858]

TABLE 2 (Continued)

Dependent variable	Target CAR		Acquirer CAR		Target CAR		Acquirer CAR	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Acquirer size	0.011	0.010	−0.002	−0.003	0.011	0.010	−0.002	−0.003
	(0.005)	(0.005)	(0.002)	(0.002)	(0.005)	(0.005)	(0.002)	(0.002)
	[0.026]	[0.039]	[0.153]	[0.146]	[0.023]	[0.053]	[0.113]	[0.092]
Acquirer Tobin's *Q*	0.024	0.023	0.001	0.001	0.024	0.022	0.001	0.001
	(0.010)	(0.010)	(0.002)	(0.002)	(0.013)	(0.012)	(0.002)	(0.002)
	[0.022]	[0.020]	[0.404]	[0.442]	[0.059]	[0.060]	[0.456]	[0.550]
Acquirer leverage	0.008	0.021	0.027	0.029	0.008	0.019	0.027	0.029
	(0.049)	(0.049)	(0.014)	(0.015)	(0.047)	(0.045)	(0.016)	(0.016)
	[0.873]	[0.672]	[0.065]	[0.052]	[0.868]	[0.680]	[0.097]	[0.081]
Acquirer profitability	0.005	−0.005	0.026	0.024	0.005	−0.002	0.026	0.025
	(0.052)	(0.052)	(0.042)	(0.041)	(0.048)	(0.047)	(0.039)	(0.038)
	[0.919]	[0.924]	[0.536]	[0.555]	[0.917]	[0.975]	[0.502]	[0.517]
Constant	−0.245	−0.131	−0.003	0.009	−0.247	0.116	−0.004	0.039
	(0.155)	(0.149)	(0.045)	(0.045)	(0.175)	(0.218)	(0.051)	(0.054)
	[0.113]	[0.382]	[0.942]	[0.842]	[0.157]	[0.595]	[0.938]	[0.464]
Observations	1,183	1,183	1,183	1,183	1,183	1,183	1,183	1,183
Adj. *R*-squared	0.299	0.314	0.207	0.210	0.299	0.319	0.206	0.211
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Country FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Notes: Political affinity *D* (*C*) captures political affinity as a dummy (continuous) variable. *SE*s are shown in parentheses, *p* values are shown in brackets. We use country pair clustered *SE*s.

seems to be related to how the CBAs are executed. For instance, we find that cash payments (stock payments) are more (less) common if political affinity is weak ($p = .000$), suggesting that target firms try to avoid stock payments if this is the case.

4 | RESULTS

To test our two hypotheses, we follow the analysis in Schijven and Hitt (2012) and use a fixed-effects model to regress the cumulative abnormal returns on the premium and the interaction term between the premium and political affinity (moderator). Table 2 presents our main results. Models (1) to (4) show the results for political affinity as a dummy variable (political affinity D), and models (5) to (8) show them for political affinity as a continuous variable (political affinity C).

We first report the results without any interaction effects of political affinity to ensure comparability to prior studies. We present the results in models (1) and (3) (models (5) and (7)) using political affinity as a standalone binary (continuous) variable (i.e., not interacted with the acquisition premium). As expected from previous studies, we find positive coefficients of the acquisition premium on CARs from targets (models (1) and (5)) ($p = .000$). Thus, the acquisition premium positively affects the target firm's stock market return to an acquisition announcement, which is in line with the results from previous studies. However, in the case of acquirers (models (3) and (7)), we do not find a statistically significant effect on CARs from acquirers (coeff.: −.007; $p = .303$). Furthermore, we find no evidence of a direct effect of political affinity on CARs since the coefficients on political affinity are insignificant.

Next, we analyze whether political affinity moderates the effect of the premium on stock returns, which we expect with H1 and H2. Models (2) and (6) for the target as well as models (4) and (8) for the acquirer additionally consider the interaction between the acquisition premium and political affinity. Here, our variable of interest is the interaction term between political affinity and the acquisition premium.[9] As both political affinity variables are constructed in such a way that higher values represent strong(er) political affinity, we expect the coefficients of the interaction term to be positive if the relationship between the acquisition premium and the target/acquirer firm's stock market return to an acquisition announcement is positively moderated by political affinity between the acquirer and target countries (H1 and H2).

We indeed find empirical evidence in line with both hypotheses. For both acquirer and target, the coefficients of the interaction term are positive and statistically significant. Furthermore, we find that our results are not particularly sensitive to how we construct the political affinity variable, as the interaction term remains significantly positive no matter whether we include political affinity as a binary or continuous variable. When we additionally consider the interaction plots shown in Figure 1 (2) to better understand the economic significances for the target (acquirer) using political affinity as a continuous variable, we see a considerable moderation effect of political affinity for both acquirer and target CARs. The acquisition premium is only significantly positive (negative) for target (acquirer) CAR when political affinity is strong (weak) and indistinguishable from zero otherwise. For the target, we find a marginally

[9]We are less interested in the standalone term premium, as it does not capture an average effect as in linear-additive regression models (Brambor, Clark, & Golder, 2006). It only captures the effect of premium on CARs when political affinity equals zero. On the contrary, the interaction term of political affinity and premium shows how the marginal effect of a premium on CARs is moderated by political affinity (which is the main research objective of this study). For a more intuitive interpretation, we refer to Figures 1 and 2 which present the marginal effect of premium on CARs for all values of political affinity within the defined value range [0;1].

FIGURE 1 Interaction plot for target. This figure presents the marginal effects of the premium on CAR for the target. The solid line represents the estimated marginal effect depending on political affinity as the continuous moderator variable. The long-dash, dash, short-dash, short dash-dot, and dot lines represent confidence intervals (upper and lower boundary) with *p* values of 15, 12.5, 10, 7.5, and 5%

significant effect of the premium when political affinity is strong (marginal effect of premium significant at $p = .1$ or less when political affinity ranges between .79 and 1) and no significant effect when political affinity is (rather) weak (marginal effect of premium insignificant with *p* values above .1 when political affinity ranges between 0 and .78). In relative terms, we find for strong political affinity (=1) that a one–*SD* increase in acquisition premium translates into a 46.7% increase[10] in target CAR relative to the *SD* of target CAR, which we argue to be an economically meaningful effect size. Then again, for acquirer CAR, we find a marginal effect of the premium only when political affinity is weak (marginal effect of premium significant at $p \leq .1$ when political affinity ranges between 0 and .71) and no effect when political affinity is strong (marginal effect of premium insignificant with *p* values above .1 when political affinity ranges between .72 and 1). In relative terms, we find for weak political affinity (=0) that a one–*SD* increase in acquisition premium translates into a 61.5% decrease[11] in acquirer CAR relative to the *SD* of acquirer CAR, which again implies an economically meaningful effect size. Concerning targets, we expected such a significant positive moderation effect as weak political affinity, as opposed to strong political affinity, increases the likelihood of government intervention (Bertrand et al., 2016), lowering the likelihood of deal completion (Zhang & He, 2014), and thus weakening target shareholders' reaction to the acquisition premium (lower positive cumulative abnormal returns). Regarding acquirers, we argue that for weak political affinity (relative to

[10]Calculated as: ((Beta premium +1 × Beta acquisition premium × political affinity) × standard deviation premium)/SD target's CAR. The corresponding calculation is hence: ((−0.604 + 1 × 0.932) × 0.419)/0.294 = 0.467.

[11]Calculated as: ((Beta premium + 0 × Beta acquisition premium × political affinity) × SD premium)/SD acquirer's CAR. The corresponding calculation is hence: ((−0.110) × 0.419)/0.075 = −0.615.

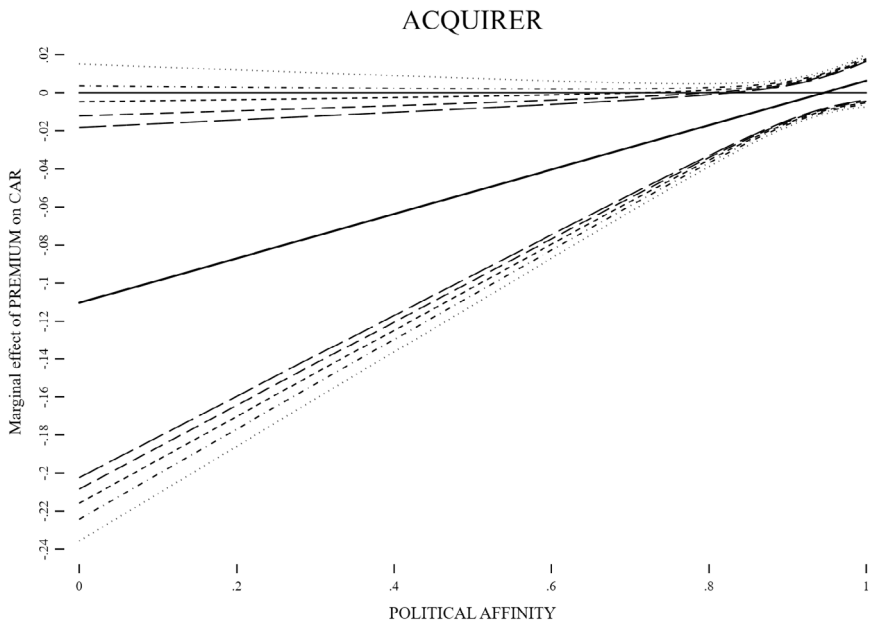

FIGURE 2 Interaction plot for acquirer. This figure presents the marginal effects of the premium on CAR for the acquirer. The solid line represents the estimated marginal effect depending on political affinity as the continuous moderator variable. The long-dash, dash, short-dash, short dash-dot, and dot lines represent confidence intervals (upper and lower boundary) with *p* values of 15, 12.5, 10, 7.5, and 5%

strong political affinity), the offer price must be high enough for the target not to resist the bid (Bertrand et al., 2016), increasing the likelihood of value destruction (Li et al., 2020) and thus strengthening acquirer shareholders' reaction to the acquisition premium (lower negative cumulative abnormal returns).

Then again, most of our control variables have the expected coefficients.[12] For instance, we find negative coefficients for poison pills (confirming the findings of Schijven and Hitt (2012)) and positive coefficients for tender offers as well as acquirer Tobin's *Q* in all models (both in line with the findings of Li et al. (2020)). Lastly, our adj. R^2 is slightly higher than in similar studies. For instance, Schijven and Hitt (2012) report an adj. R^2 of up to 13% whereas ours ranges between 20.6 and 31.9%, which is likely due to a wider set of fixed effects employed in our study. Overall, both the coefficients of the control variables as well as the overall model fit suggest that our models capture a reasonable share of variation of acquirer and target CARs.

We also perform a battery of robustness tests to ensure the validity of our main results.[13] First, we exclude any firm control variables to reduce the risk of an overfitted model. Second, we use the factors from the widely used Carhart (1997) four-factor model instead of using the six factors from our main model to determine abnormal returns to

[12]As some of our control variables are scaled by total assets, we may be prone to a ratio error correlation arising from the repeated inclusion of the same variable as a scaling factor (Farris, Parry, & Ailawadi, 1992; Hitt, Hoskisson, & Kim, 1997). To mitigate this concern, we follow the recommendation of Wiseman (2009) and repeat our main analysis, this time including all control variables in unscaled form (i.e., no descaling with total assets). Our results continue to hold.

[13]Results tables for all additional tests are available from the authors upon request.

ensure our results are not sensitive to the economic model selected. Third, we use an alternative event window from 3 days before to 3 days after the announcement event to verify whether our results are sensitive to this methodological choice. Fourth, to analyze how our findings are affected by the fixed effects (which potentially increase the likelihood of overfitting), we do not use any fixed effects or use an industry, year, and/or country demeaning approach instead of the respective fixed effects regression model as another way to mitigate overfitting concerns. For all robustness checks, we find that the interaction term is positive, similar in magnitude and, in most cases, statistically significant. Our robustness tests support the empirical evidence provided in Table 2, stating that the relationship between the acquisition premium and the target/acquirer firm's stock market return after an acquisition announcement is positively moderated by political affinity between acquirer and target countries.

5 | DISCUSSION AND CONCLUDING REMARKS

This study makes two important contributions to the literature. First, we contribute to the emerging literature that looks at the heterogeneity of bilateral relations in CBAs. With our focus on political affinity, we directly extend Bertrand et al. (2016). While they provide evidence that managers incorporate political affinity into their perception of a deal's synergistic potential (i.e., premium paid), we additionally show that investors assess a deal and the acquisition premium paid differently depending on political affinity. As we find a positive moderation effect for political affinity, we argue that investors of acquirers (targets) are particularly worried about overpayment (intervention likelihood and deal completion) when political affinity is weak. Second, we contribute to research on investor reactions from a behavioral perspective. Here, we connect with Schijven and Hitt (2012) who, using a sample of deals involving North American acquirers, show that investors' reaction to the acquisition premium paid is moderated by factors such as industry similarity, acquirer performance, and deal characteristics (e.g., payment structure). While these factors are relevant to all deals (i.e., both domestic deals and CBAs), with political affinity we focus on an important factor that is relevant only to CBAs (Bertrand et al., 2016). This is an important extension, as CBAs introduce additional complexity for investors (in contrast to domestic deals), and we argue that it is hence ex-ante unclear whether investors are capable of or willing to incorporate political affinity as another piece in the crude information set available to them (Schijven & Hitt, 2012) into their assessment of CBAs. Our findings of a positive moderation effect linked to political affinity suggest that both acquirer and target shareholders indeed incorporate political affinity into their overall assessment. This is in line with the argument that investors have incomplete information, use the acquisition premium paid as a proxy for assessing the reliability of management's perception of a given deal's synergistic potential, and complement this proxy with political affinity as a major element of bilateral political relations (Bertrand et al., 2016) when assessing CBAs.

Our results are important from a management perspective. Investors often face crude signals when assessing acquisitions, particularly the premium paid (Schijven & Hitt, 2012). In the context of CBAs, political affinity may serve as a relevant signal to investors for evaluating the premium paid (i.e., potential overpayment). This signal should become less relevant if firms provide more reliable and relevant information to investors, which should in turn allow them to better manage investors' reactions to deal announcements.

At the same time, it may be more beneficial for acquiring firms to focus on targets in countries with a strong political affinity to their own. For governments, our findings illustrate that their conduct in global affairs may have real economic consequences for their companies. Major disagreements with other countries may lower the likelihood of M&A deals with these countries; and even if these deals take place, the terms and conditions may be less favorable, as shown in Bertrand et al. (2016), and there may be more negative investor reactions to given deal conditions, as suggested by our study.

Finally, our study has two main limitations that open up avenues for future research. First, political affinity is an imperfect proxy for the similarity of national interests at the global level. We focus on UN General Assembly voting behavior as we seek to use a measure that applies to all countries. Yet international institutions in other geographical regions (e.g., the European Union and its political bodies) may also be relevant for investors when they assess the acquisition premium paid. Future research could investigate acquisitions in these regions to see whether political affinity matters differently there. Second, with our quantitative-empirical approach, we are unable to identify the actual channels through which political affinity affects individual investors' reactions (i.e., we can only observe aggregated market returns). Future studies could conduct investor surveys to better understand the moderation channels of political affinity and thereby determine heterogeneous effects depending on investor characteristics such as risk preference.

DATA AVAILABILITY STATEMENT

The data that support the findings of this study are available from WRDS/SDC Platinum/Datastream. Restrictions apply to the availability of these data, which were used under license for this study. Data are available via WRDS/SDC Platinum/Datastream.

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SUPPORTING INFORMATION

Additional supporting information may be found online in the Supporting Information section at the end of this article.

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