Getting by with a Little Help from My Friends: The Relevance of Political Affinity for the Bidding Strategy in Cross-Border Acquisitions

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ABSTRACT

We investigate the relevance of political affinity between countries for a firm’s bidding strategy in cross-border acquisitions. We argue that it affects the bargaining position that foreign acquirers anticipate to have in the negotiations with domestic target firms because it reduces the extent of political help from the domestic government a target firm can expect to rely on during the acquisition process. We find strong evidence that political affinity, as revealed by UN voting patterns, leads to lower initial acquisition premiums and influences other bidding choices. Supplementary analyses identify political contingency factors and show that shareholder expectations are also positively related to political affinity. This research contributes to the small, but growing literature on the implications of international relations for corporate business transactions.
INTRODUCTION

Wikileak cables have recently revealed to the public how business and politics are intertwined all around the world (Lipton, Clark, and Lehren, 2011). These cables in particular suggest that favorable bilateral political relations can be critical for the success of international business transactions. For instance, diplomats regularly speculated on the implications of the special relationship between the former Prime Minister of Italy Berlusconi with Russia’s president Putin for business outcomes or on the privileges of Chinese firms in African countries with which the Chinese government had excellent political relations (Copson, Dumbaugh, and Lau, 2005; Shane and Lehren, 2010).

In spite of numerous anecdotes in the media on the importance of this phenomenon and its potential impact on international deals, we still know very little about the mechanisms at play and the channels through which bilateral political relations are incorporated in business decision-making. The relevance of bilateral country relations and foreign policy for firms remains an under-investigated topic. In this paper we focus on political affinity, an underlying driver of “special relationships” between governments. We explore the role of political affinity in the context of cross-border acquisition-making. We analyze its impact on the acquiring firm’s strategic bidding behavior, in particular the initial bid (or acquisition) premium. Studying the strategic bidding behavior permits us to capture the expectation of foreign acquirers concerning the implications that political affinity has on their bargaining power with the target firm. We argue that a forward-looking foreign acquirer anticipates a lower bargaining power of the target firm with a higher level of political affinity between the home and host countries, because higher political affinity reduces the likelihood of government intervention in favor of the domestic target firm and, in general, the extent of political discrimination the foreign firm is likely to face.
in the host country. Overall, foreign acquirers are usually exposed to substantial challenges in the host country, not only with regard to the economic or cultural environment, but also to the political context (Boddewyn and Brewer, 1994). The existence of protectionism or political intervention by the host government against foreign firms – also called economic nationalism – has been illustrated in numerous anecdotes (e.g., Bertrand et al., 2012; Clifton and Diaz-Fuentes, 2011) and has been subject to a few empirical studies in the context of the European Union (EU) (Aktas, De Bodt, and Roll, 2004; 2007; Dinc and Erel, forthcoming). These studies, however, have not distinguished among foreign acquirers. But the nationality of the acquirer can play a critical role in the decisions made by the host government since the quality of political relations may substantially vary across country dyads.

Previous studies that have linked interstate relations with business activities have mainly explored the relevance of military conflicts or political agreements between countries, such as military alliances or international trade and investment agreements, for patterns of international business (Buthe and Milner, 2008; Egger and Merlo, 2007; Li and Sacko, 2002; Li and Vashchilko, 2010; Nebus and Rufin, 2010; Ramamurti, 2001; Rangan and Sengul, 2009). Multilateral international organizations or bilateral international agreements have been viewed mainly as platforms to increase country interactions, norm diffusion, and trust (Rangan and Sengul, 2009), or as mechanisms to generate credible commitments towards foreigners (Hafner-Burton, von Stein, and Gartzke, 2008).

This paper focuses on political affinity, defined as the similarity of national preferences in global affairs (Gartzke, 1998). We investigate a higher order process through which the willingness of countries to pursue a cooperative or conflictual relationship with a partner country not only explains its actions in the political, but also in the international business arena. While
the implications of political affinity for decisions in the political domain have been part of the
debate in the international relations literature already for many years (Gartzke, 1998), its impact
on cross-border business transactions has been largely neglected in contrast to the vast literature
that has analyzed the effects of cultural or institutional distances (Ahern, Daminelli and Fracassi,
forthcoming; Dikova, Rao Sahib, and van Witteloostuijn, 2010; Dinc and Erel, forthcoming;
Kogut and Singh, 1988; Kostova and Zaheer, 1999). Political affinity has only very recently been
considered as an explanatory variable by Johan, Knill, and Mauck (2013) and Knill, Lee and
Mauck (2012) in the context of sovereign wealth fund (SWF) activities. While these authors
relate political affinity with the political goals of investment funds governed by states, our focus
is different. We shift the theoretical and empirical discussion of the implications of political
affinity for foreign investments to those conducted by non-institutional investors without direct
state involvement, hereafter simply referred to as private non-financial firms or strategic
acquirers. Through investments abroad the firms we examine are willing to gain strategic control
over the management of the target firm with a primarily long-term profit-maximization goal that
is a priori free of political motives.

To gain insights into the channels through which international relations are at play in
business decision-making, we focus on the importance of political affinity for the bidding
strategy of foreign acquirers in international M&A (Merger and Acquisition) deals, contrary to,
for instance, Johan et al. (2013) and Knill et al. (2012). We argue that political affinity affects
firm strategy and international transactions by changing the expectations of foreign acquirers
concerning the bargaining power of the target firm during the pre-acquisition process. In M&As
such an effect should be best captured in the behavior of firms in the pre-announcement period or
bidding phase.
The size of the initial acquisition premium is considered as the most important decision that has to be taken in a firm’s bidding strategy (Eckbo, 2009) and has been used as the main variable of interest in this context (Aktas, de Bodt, and Roll, 2010). The initial bid premium signals the confidence of acquirers in their ability to win the bid (Haleblian, et al., 2009; Hayward and Hambrick, 1997). Albeit largely overlooked by the literature in management, “[a]cquisition premiums are an interesting and important area […] because there is so much variation in premiums, and large premiums can be disastrous” (Haunschild, 1994: 393). Gaining a better understanding of the initial bid premium is important since paying too much has been very often suggested as one major reason for the widely observed underperformance of M&As (Agrawal and Jaffe, 2000; Haunschild, 1994; Hayward and Hambrick, 1997; Sirower, 1994). Overpayment increases the uncertainty about the M&A success and may, eventually, jeopardize the performance of the acquirer by diverting too many financial resources from other necessary investments or obliging the acquiring firm to take cost-reduction decisions harmful in the long run (Krishnan, Hitt, and Park, 2007). Other major strategic decisions in the bidding phase that we study in this paper relate to the “pre-bid ownership stake (toehold) in the target, and selecting an optimal payment method (mix of cash and securities)” (Eckbo, 2009: 150).

In this context, we argue that forward-looking foreign acquirers incorporate the political dimension into their decision-making process during the bidding phase. They expect that higher political affinity between the home and host country will make it less likely that the host government will shield the target firm by supporting other potential domestic bidders or by helping target management in blocking the acquisition. As a result, with increasing political affinity, foreign acquirers anticipate target firms to be in a less favorable negotiation position and
reduce their initial offer price. We expect that firms that find themselves in this favorable position will also adapt their toehold strategy and payment method.

We empirically test the relationship between political affinity and the acquisition premium on a sample of 715 cross-border acquisitions from 1990-2008. This sample is limited to listed target firms and, hence, includes large targets and acquirers. Large cross-border M&As are economic events that are visible and well-advertised; foreign bidders can anticipate that such deals are likely to attract the attention, efforts, and resources of governments (Clougherty, 2003; Saner, Yiu, and Sondergaard, 2000). The sample excludes deals where state actors were involved (including SWFs) or associated with financial or institutional investment firms to keep our focus on strategic acquirers. We measure political affinity “based on the similarity of nations' roll-call voting in the United Nations General Assembly” (Gartzke, 1998: 12).

We find robust evidence that the initial premium proposed to the target firm in cross-border deals is, *ceteris paribus*, negatively related to political affinity. Controlling for economic, cultural, and other institutional distances, we show that the political affinity effect is both statistically and economically highly significant. In addition, political affinity consistently affects strategic choices in terms of payment method and toehold. Moreover, in supplementary analyses, we empirically identify political contingency factors of the political affinity effect on the M&A premium: It is moderated by the host country political environment (namely by government weakness and the extent of nationalism) and domestic political connections of the target firms. We finally show that not only managerial expectations towards the deal, as revealed in their bidding strategy, are influenced by political affinity, but also the expectations of the stock market. These results are important given the dominant role of cross-border acquisitions in FDI flows and their impact on host economies (UNCTAD, 2000). The findings highlight not only an
important mechanism at play at the intersection of international relations and cross-border business activities, political affinity, but also, with the bidding strategy, help to identify a channel through which international relations shape firm strategic behavior and hence business success.

Our study contributes to the literature by linking international relations with international strategy and finance. Political affinity enables us to highlight a characteristic of the bilateral relationship between countries which can alter the nature and intensity of political interference in the host market. The emphasis on political affinity allows for moving the attention from the role of cultural or institutional distance that has been abundantly discussed in the International Business (IB) literature to the importance of political friendship. Compared to most previous research on international relations in IB that has been done at a macroeconomic level, we extend the analysis to firm-level strategic decisions in international deals. We primarily focus on the bidding strategy of the firm and, in particular, the initial acquisition premium. The role of the host country political environment and of firm-level domestic political connections or, more broadly, political corporate strategy, has been extensively discussed through different lenses in strategy (e.g., Delios and Henisz, 2003; Hillman, Keim, and Schuler, 2004; Holburn and Zelner, 2010) or in finance (e.g., Faccio, 2006; Faccio, Masulis, and McConnell, 2006; Fisman, 2001). Only a few studies have investigated government intervention in business transactions (Aktas et al., 2004, 2007; Dinc and Erel, forthcoming). This research stream, however, overlooks international relations and, thus, the heterogeneity of bilateral political relations. In this paper we take into account the quality of interstate relations, focusing on political affinity. To our knowledge only, Knill et al. (2012) and Johan et al. (2013) have very recently studied the role of interstate relations and, in particular, political affinity. Our work is complementary. While they focus on SWFs, we examine the strategic behavior of private non-financial firms and argue that
political affinity matters for cross-border acquisitions made by these firms driven primarily by strategic and long-term profit-maximization goals. Interestingly, Knill et al. (2012) find that political affinity deters investments from SWFs. They interpret this result as evidence that state-players use SWFs as an instrument to fulfill political goals. We arrive at opposite conclusions and findings for private non-financial firms. Both acquirer management and the stock market positively value political affinity in these strategic international acquisitions. We also go beyond their studies by exploring political contingency factors. Overall, our empirical set-up and theoretical focus differ from the cited research works.

The remainder of the paper is structured as follows. We start by developing our hypotheses on the implications of political affinity for the bidding behavior of the foreign acquirer. We then describe our data and methods before reporting our empirical results for the bidding strategy. In a supplementary analysis section we proceed to further empirical investigations, analyzing the political drivers of affinity outcomes and the effect of political affinity on shareholder reactions to international deals. Finally, we discuss our findings and indicate the contributions and limitations of the study.

THEORY AND HYPOTHESIS

Political affinity in international business

The importance of the bilateral political relationship between countries for firms operating in international markets has been analyzed in the IB field primarily in a two-tier negotiation framework (Frynas, Mellahi, and Pigman, 2006; Nebus and Rufin, 2010; Ramamurti, 2001). In this framework, Tier 1 examines home and host country government negotiations that concern
business matters.\textsuperscript{1} Tier 2 relates to the bargaining that occurs directly between multinational enterprises (MNEs) and the host country government. Tier 1 negotiations can shape the political framework within which firms bargain on the micro-level in Tier 2 or, more generally, even without any MNEs-host government interactions, the level of political discrimination foreign firms are confronted with in the host country.

A government may choose to support or oppose the activities of foreign firms in their economy (Hymer, 1976; Stopford and Strange, 1992). Due to informational asymmetries or stereotypes (Kostova and Zaheer, 1999; Zaheer, 1995), foreign firms, however, suffer from a liability of foreignness, making them more likely than domestic firms to fail in their political behavior and to experience political discrimination in general and unfavorable government intervention in particular (Boddewyn and Brewer, 1994; Eden, Lenway, and Schuler, 2005; Hillman and Wan, 2005). Government intervention can take different facets; it can be direct (e.g., via regulatory measures; see Dinc and Erel, forthcoming), or indirect through its vast political and business network (Colignon and Usui, 2001; Kadushin, 1995; Kim, Pantzalis, and Park, 2012).

We, however, still know very little about what drives political discrimination in the host market and how the nature of the political relationship between countries may affect decisions taken by the host government. We argue that the similarity in preferences in global affairs of the host and home country shapes host government behavior and the extent of political discrimination foreign firms eventually experience in the host market. In the international relations literature the character of bilateral political relationships has been associated with the

\textsuperscript{1} Previous research on this issue has mostly explored formal bilateral or multilateral agreements and linked them to their role as platforms to increase interstate exchange, economic liberalization, norm diffusion, and trust (e.g., Ramamurti, 2001; Rangan and Sengul, 2009) or as mechanisms to increase the credibility of government policies towards foreigners (e.g., Buthe and Milner, 2008; Hafner-Burton \textit{et al.}, 2008).
“willingness” (Gartzke, 1998: 6) of governments, usually the most influential actors in affecting foreign policy outcomes in a country (Moe and Howell, 1999), to engage either in conflictual or cooperative actions in relation to each other. This willingness is shaped by a country’s “objectives in global relations” (Gartzke, 1998: 7). When “global objectives coincide” (Gartzke, 1998:12) and countries share “world views” (Gartzke, 1998: 7), political affinity is positive or high. Similar interests make conflicts less probable (Gartzke, 1998; Kinsella and Russett, 2002). Governments are more likely to take cooperative actions and act as a friend.

Just as political affinity is argued to affect government behavior in the political arena, we posit in this paper that it can influence the intensity and nature of political intervention in the host country in cross-border business deals. The relevance of the quality of political relations for cross-border business deals has been illustrated numerous times in the media and, although much less frequently, in academic research (Frynas et al., 2006). While positive political affinity opens the door for economic cooperation, transactions of firms from less friendly countries are rendered more difficult. The notion of political affinity is thus distinct from that of cultural distance or institutional distance that has been extensively studied (Ahern et al., forthcoming; Dikova et al., 2010; Dinc and Erel, forthcoming; Kogut and Singh, 1988; Kostova and Zaheer, 1999). In particular, distance in cultures relates to the degree of divergence in the “personality” of the “human collectivity” found within the boundaries of one country (Hofstede, 1980: 21). Differently, political affinity refers to the extent of preference alignment between nation-states, where these preferences concern issues relevant in global affairs. Differences in institutions are associated with the differences in the rules that structure human interactions (North, 1994) in the two countries. In contrast, political affinity focuses on the degree of similarity of national interests in the international arena. These interests are shaped by a variety of factors including
“governing structures or political cultures” (Gartzke, 1998: 7), but also “national wealth, geography, culture, ethnic identity, and idiosyncratic political agendas” (Gartzke, 1998: 12). Political affinity provides a dynamic construct on world views and gives a different texture explanation of the contact between foreigners and local agents.

In the two-tier framework, political affinity can shape the host environment that the foreign firm is confronted with during a cross-border deal by altering the negotiations taking place in Tier 1, such as those concerning formal treaties or other diplomacy outcomes, and those at the micro-level in Tier 2. The home government may leverage the good relation between governments and more easily intervene in favor of the economic interests of its firms. Even without any negotiations taking place on Tier 1 or 2, political affinity should matter; it affects the willingness of the host government to act in favor of or against a foreign firm and contributes to determining the level of political discrimination the foreign firm is confronted with during a cross-border business deal. In such a context, we assert that forward-looking foreign firms are aware of international political issues and take into account the level of political affinity between their home and host countries in their decision-making.

**Political affinity and the acquiring firm’s bidding strategy**

In this paper, we examine the relationship between political affinity and the acquirer’s bidding strategy in international acquisition deals. We posit that political affinity modifies the bargaining power that the foreign acquirer anticipates to have vis-à-vis the target firm during the pre-announcement period or bidding phase.

During this phase, the level of the initial bid premium – which refers to the difference between the price proposed for a target firm and the pre-acquisition market value – has been
recognized as a major strategic decision taken by the acquiring firm (Aktas et al., 2010; Haleblian et al., 2009; Officer, 2003) and has even been identified as the most important bidding parameter (Eckbo, 2009). When setting the initial offer price, the acquiring firm wishes to pay as little as possible for the target firm in order to minimize the overall cost of the acquisition (Haunschild, 1994; Haunschild and Beckman, 2002; Reichheld and Henske, 1991). The acquirer, however, can only win the bid if target shareholders agree to a sale. These shareholders will only accept the deal if the offer price is above the expected post-acquisition value (Grossman and Hart, 1980) or the value of the firm in case that the transaction does not take place, namely, in case that the target stays independent or is acquired by a third-party (Betton, Eckbo, and Thorburn, 2008; Schwert, 1996). For instance, in August 2010, the initial bid of the Australian firm BHP for the Canadian Potash Corporation, the world’s largest fertilizer producer, was perceived to be set so low, that target management felt “insulted” and chose to reveal the Australian bidder to the public and pursue other strategies to raise the standalone value of the firm (McNish, Bouw, and Reguly, 2010). Forward-looking acquirers need to incorporate these constraints into their initial bid, i.e., proposing a price that is low enough to be profitable, but high enough to convince target shareholder to sell. An acquirer also has to consider the first-mover advantage that initiating a bid might offer, like pre-empting competition (Fishman, 1988). Acquirers, therefore, have to set the initial premium such that it discourages the target firm from opposing the bid, taking resistance strategies to increase the target’s standalone value, or accepting a competing offer.

Due to their liability of foreignness, foreign acquirers are particularly exposed to uncertainties and challenges during the acquisition price negotiations with the local target firm (Dikova et al., 2010). Empirical evidence suggests that they, on average, pay a higher premium than domestic bidders (Rossi and Volpin, 2004). Therefore, when deciding on the initial offer
price, foreign acquirers need to investigate the cross-border context in which the deal takes place and, in doing so, consider the level of political affinity between countries. If the host government acts in favor of local target firms, it raises the bargaining power of the latter and the acquisition price they are able to claim. Target firms can proactively ask for help of the government in the bargaining phase. Consultants from the legal consulting group Davies Ward Phillips & Vineberg LLP (Thomson, Bodrug, and Damiani, 2010) even advise target firms to utilize government protectionism to defend themselves: “[…] the target is often best placed to identify hot button [regulatory] issues and advance them quickly and effectively” (Thomson, Bodrug, and Damiani, 2010: 47). But even if target firms remain passive, governments may interfere in their favor in the pre-acquisition phase, as the case of the bid of Mittal Steel for Arcelor in 2006 illustrates. “French intelligence services have been used to monitor potential bids. Reportedly, intelligence services alerted Arcelor on November 17 of Mittal Steel's bidding intentions, two months before the bid became public” (Wikileaks, 2006). Overall, the intervention of the host government could affect the strength of target firms to oppose foreign acquisitions by reducing information asymmetries, influencing their standalone value, or the threat of alternative acquirers. Recent research has confirmed that foreign acquirers are more likely to experience unfavorable government intervention (Aktas et al., 2007; Dinc and Erel, forthcoming) than domestic ones.\(^2\)

Nevertheless, we argue that the actual degree of political discrimination faced by foreigner acquirers depends on their nationality and the political relations between the home and

\[^2\text{In line with political affinity considerations, the host government can interfere in the acquisition process through various channels. For instance, through persuasion or regulatory measures the government can exercise direct pressure on target firms to accept or refuse the deal. A government can also leverage its power as a major customer or use its influence on the local community to reduce or increase resistance to the transaction. Moreover, a government can often exert impact on banks and thus affect the target firm’s access to loans or other forms of finance; similarly, it can affect labor unions and employee-employer negotiation outcomes during the deal process. In general, a government is able to de- or increase the stand-alone value of the local target firm by, for instance, (not) granting subsidies or giving regulatory advantages. Through political-business networks, a government can also function as an intermediary that allows, for instance, a foreign acquirer to be introduced to the target firm or the target firm to find alternative domestic partners to counter the foreign acquirer’s initiative.}\]
host countries as captured by political affinity. The higher the political affinity, the less likely the host government will act against the foreign acquirer at the benefit of the local target firm. Hence, foreign acquirers can expect a higher political affinity to decrease the ability of target firms to leverage the host government, consequently reducing the target firms’ bargaining power during price negotiations. With a higher level of political affinity, acquirers will then propose a lower initial acquisition premium, anticipating such an offer to be sufficient to buy a target firm. In setting the initial price, it is the expectation towards political discrimination that matters, not the actual level that is then experienced. Indeed, if correctly set, government intervention might not take place at all. Target firms will be willing to sell immediately since the offer surpasses or equals the minimum price they require. They could even be willing to help foreign acquirers to overcome government resistance as, for instance, experts suggested in the case of the unsuccessful bid of BHP for Potash Corporation. “A senior Canadian investment banker said the low offer failed to whet the appetite of Canada's biggest and most powerful investors - the pension funds. If those funds and other big-name investors couldn't resist the offer, he said, they would have put enormous political pressure on Premier Wall and top federal politicians to approve the deal. […] If BHP had made a real bid, there would have been a cacophony of large shareholders telling the governments to butt out” (McNish, Bouw, and Reguly, 2010).³

³ In such circumstances bidding high is advised by legal consultants: “[For bidders] it may be well advised to open with a relatively higher bid price to minimize the prospects for an aggressive regulatory defence strategy by the target” (Thomson, Bodrug, and Damiani, 2010: 47)
Hypothesis 1: There is a negative relationship between the initial acquisition premium for cross-border acquisitions and the level of political affinity between acquirer and target countries.

Following the same line of reasoning, we predict that political affinity also influences other strategic bidding elements. In a bidding strategy, “[i]n addition to the initial offer premium and subsequent bid revisions, strategic choices include acquiring a pre-bid ownership stake (toehold) in the target, and selecting an optimal payment method (mix of cash and securities)” (Eckbo, 2009: 150). Accordingly, we focus on the impact of political affinity on these two strategic parameters.

A toehold reduces the risk and the costs of an acquisition since only a lower stake needs to be acquired at a premium in the control acquisition (e.g., Chowdry and Jegadeesh, 1994; Hirshleifer and Titman, 1990). Nevertheless, only a small number of companies actually use toeholds as a platform for further acquisitions (Betton, Eckbo, and Thorburn, 2009; Choi, 1991). This paradox has been explained by the hostility of target management to acquisition offers associated with toeholds. The establishment of a toehold is perceived as an aggressive move which raises target management resistance to the bid (Betton et al., 2009) and hence the costs of the acquirer in overcoming this resistance. Also, in case that an acquisition fails, the pre-bid target shares of the acquirer can lose in value as target management resistance to the deal may lead to value reducing defensive measures or signal strong management entrenchment in general (Goldman and Qian, 2005). A toehold can, therefore, reveal the acquirer’s perception of the degree of target resistance it will face in the control transaction: An acquiring firm opts for a toehold-based acquisition only if it expects that the target management will not be able to defend
itself successfully. In our context, we argue that political affinity reduces the chances that a target firm can rely on political or regulatory mechanisms to improve its bargaining position during a bid. Therefore, establishing a toehold should become less risky with a higher level of political affinity for forward looking acquirers as target management is less likely to leverage political power to block the acquisition. We propose:

**Hypothesis 2**: There is a positive relationship between the likelihood of a foreign acquirer to use a toehold strategy in a cross-border acquisition and the level of political affinity between acquirer and target countries.

Also, the choice of the offered payment method depends on the anticipated relative bargaining power of the acquirer and target. For the acquirer a cash payment is less desirable in an acquisition since it requires a higher cash outlay and is riskier than a payment via shares. In case of a stock payment the value of the offer is contingent upon the future performance of the acquiring firm (Sudarsanam, 1995). The target firm thus shares the risks of the acquisition failure and, more generally, of a possible negative revaluation after the bid's completion (Martynova and Renneboog, 2009). For the same reason, target shareholders usually prefer a cash offer. It is simple to evaluate and provides a safe return. A stock offer from the acquirer’s side could even suggest that the acquirer’s stocks are overvalued (Peterson and Peterson, 1991). In sum, equity payments are less likely to convince target shareholders to sell and to decrease any deal-related resistance (Sudarsanam, 1995). In the opposite, cash payments tend to signal the high valuation of the target firm by the acquirer. Several research works have thus shown that a cash offer tends to deter competitive offers for the target firm (Fishman, 1989; Giammarino and Heinkel; 1986; Hirshleifer and Png, 1989; Peterson and Peterson, 1991). In our context we argue that a higher
level of political affinity reduces the risk of host government intervention in favor of the target firm for the foreign acquirer. As a result, the foreign acquirer can provide lower incentives to target shareholders to sell. The acquirer can more easily switch from a cash to a stock payment in order to reduce the risk and the costs related with the acquisition deal. Hence, we state:

**Hypothesis 3**: There is a negative relationship between the likelihood of a foreign acquirer to make a cash offer in a cross-border acquisition and the level of political affinity between acquirer and target countries.

**METHODOLOGY**

**Data and sample**

The sample is obtained from the Thomson ONE (former SDC) database. We selected deals that were either completed or withdrawn within the period 1990-2008 and had premium and financial statement information (namely total assets, EBITDA, and firm debt) available for the acquiring and target firms. We excluded divestitures of assets, leveraged buy outs, and joint ventures and only kept deals where the acquirer purchased more than 50 percent of the equity of the target firm and hence gained majority control. Moreover, we removed transactions where states were involved either as acquirers or targets (including SWFs) or were associated with financial or institutional investment firms. Such deals are likely to be driven by other considerations (Karolyi and Liao, 2013). The sample is further limited due to the availability of our other explanatory variables.

The final sample consists of 715 cross-border deals from 31 (26) acquirer (target) nations (see the appendix for further details on our acquisition sample). These acquisitions took place in a variety of industries going from primary to services industries (excluding financial services).
Manufacturing and service industries contained the majority of acquisitions (respectively 46% and 22%), followed by the primary industry (with 14%).

**Dependent variable**

Our main dependent variable $P_{ijt}$ is the value of the initial premium of the offer price to the target closing stock price four weeks prior to the original announcement date as reported by the Thomson One database. Based on the analysis of SDC premiums by Officer (2003) and following Hope, Wayne, and Vyas (2011) we trim the premium data to eliminate outliers by dropping the largest and smallest 2 percent of initial bids. In our sample, the four-week initial bid premium has an average value of 44.67 (percent) and a standard deviation of 37.08.

The two other bidding parameters are cash payment and a toehold strategy indicator. The cash variable is equal to one if the bid is offered only in cash, and zero otherwise (Aktas et al., 2004). 65% of the transactions in our sample are cash bids. The toehold variable takes the value one when the acquirer has committed to a toehold strategy, and zero otherwise. Following Betton et al. (2009), we assign the value one if the acquirer has a minimum ownership position of 10% in the target prior to the control acquisition. 11% of our sample acquirers pursue a toehold-based control acquisition.

**Empirical model**

The acquirer’s initial bid premium can be modeled as follows: $P_{ijt} = f(C_{ijt}, X_{ijt}, D_{ijt}, I_{ij}, T_{ij})$

where $P_{ijt}$ is the initial bid premium at which the acquiring firm $i$ announces to take over the

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4 In a robustness check we also include hybrid offers that involve both cash and stock payment in the cash indicator variable as a one. Results are similar and available on request.

5 Betton et al. (2009) argue that due to the specific cost-benefit structure of toehold strategies there is a minimum toehold, or prior stockholding threshold, that is needed for an acquirer to gain, which they estimate at 9%. Our estimation results are similar when taking the exact 9% cut-off.
firm \( j \) at time \( t \). The vector \( C_{ijt} \) represents the country-level variables that are related to acquirer \( i \) and target \( j \). The vector \( X_{ijt} \) indicates firm-level attributes of acquirer \( i \) or target \( j \), while \( D_{ijt} \) are characteristics particular to the focal deal. We add a vector of year dummies \( T_t \) and industry dummies \( I_j \) to account, respectively, for time specific effects and unobserved industry heterogeneity. We use the same model for explaining the acquisition payment method and the toehold strategy.

**Independent variable**

The vector of country-level characteristics \( C_{ijt} \) includes our focal variable, the political affinity of countries, which we measure using the voting patterns in the United Nations (UN) General Assembly (Source: Gartzke, 1998).\(^6\) Previous research in political science has demonstrated the value of utilizing UN voting patterns as a means to account for the alignment of national preferences and thereby political affinity between countries (e.g., Gartzke, 1998; Stone, 2004). In the UN General Assembly, as opposed to the UN Security Council, the public stance on a large number of issues is revealed and countries are relatively free to express sincere preferences since the cost that they incur for showing them are small (Gartzke, 1998). For the case of African countries, for instance, Stone (2004) highlights that “patrons are not concerned about how African countries vote in the UN General Assembly but, rather, that these votes are unimportant enough to serve as a sincere measure of countries' foreign policy preferences” (Stone, 2004: 580). UN General Assembly voting thus captures more than just military or security interests (Voeten, 2000). Those countries that vote together are expected to be friends and those with

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\(^6\) Political affinity is based on Spearman rank-order correlations of roll-call voting patterns in the UN General Assembly with values ranging between -1 and 1. Dyads which have the same voting pattern obtain the value 1, while those with a complete opposite voting pattern are assigned the value -1.
negative affinity scores are, ceteris paribus, more likely to be considered as “enemies” […]” (Gartzke, 1998:15). UN General Assembly voting gives a fine-grained measure of country preferences that varies over time. UN voting covers almost the total universe of countries and is available over a long period of time.\footnote{Such political subtleties have been only partly captured by previous research. International formal institutional arrangements do not fully reflect the nuances by which bilateral political relations are made up and which shape foreign policy outcomes (Boehmer, Gartzke, & Nordstrom, 2004). Membership varies little over time as countries very rarely withdraw from ratified agreements or leave international organizations once admitted (Gartzke, 1998). Multilateral organizations in themselves also include a variety of national preferences of constituent countries (Boehmer et al., 2004). Similarly, bilateral agreements may imperfectly reveal the similarity of preference of countries as agreements could reflect competitive economic pressures to gain access to capital (Elkins, Guzman, & Simmons, 2006), regional security needs, or the effects of a third party (Werner, 1997).}

Political affinity is biased towards positive values: The majority of observations in our sample are above zero (83%). But, with its mean of 0.31 and standard deviation of 0.37, this bias is less pronounced than in the universe of country dyads included in the original database (comprising a total of 189 countries), where political affinity exhibits a mean of 0.67 and a standard deviation of 0.29 over the same period 1990-2008.

\textbf{Control variables}

To account for other variables that possibly explain a firm’s bidding strategy we include a number of control variables. All our monetary data are expressed in US dollars and are deflated using the GDP deflator (Source: World Bank).

First, we control for other country dyadic factors $C_{ijt}$ reflecting the degree to which the country of acquirer $i$ differs from the country of target $j$. We account for institutional differences between the two countries. We first consider the cultural distance between countries, using the Kogut and Singh (1988) index based on Hofstede’s (1980) data (see, e.g., Hope et al., 2011). Also, we include differences in the political system and shareholder governance. We use the PolityIV score (Source: Center for Systemic Peace) to capture the political regime (e.g., Munck...
and Verkuilen, 2002). For shareholder governance, we resort to a time-invariant measure for shareholder protection that is computed using the updated version of the anti-director rights index from La Porta, Lopez-de-Silanes, and Shleifer (2008). This index is multiplied with the rule of law, following the methodology of Wurgler (2000). Political affinity could be in particular co-determined or the result of political regime or cultural similarities. Nevertheless, there exists strong heterogeneity of national preferences even within similar regime types or cultures (Gartzke, 1998; Gartzke and Gleditsch, 2006). At the country dyadic level, like Rossi and Volpin (2004) or Bris and Cabolis (2008) we, furthermore, consider the GDP per capita differences to capture cross-country economic development disparities (Source: World Bank). It is calculated as the difference of the natural logarithm transformed values of acquirer country \(i\) and target country \(j\).

In our estimations we include several firm-specific control variables \(X_{ijt}\). We account for the difference of the size of target and acquiring firms (taking the natural logarithm transformed value of their total assets) and control for the profitability of target and acquirer firms (using the ratio of EBITDA over total assets). We also include their debt ratios (i.e., the ratio of total debt over total assets) and the M&A experience of the acquirer \(i\) (as computed by the number of completed acquisitions prior to the focal acquisition).

For deal specific variables \(D_{ijt}\) we include variables that indicate if the deal is completed, if there are competing bids, if the bid is a tender offer, and if it is hostile. We also account for the industry relatedness of firms. Acquisitions are defined as horizontal when both business partners are within the same 2-digit SIC industry. Finally, we account for the percentage

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8 Our data supports this. We find that the correlation between political regime similarity, or cultural distance, and political affinity is low.
sought in the target firm and if the deal is paid in cash when we estimate the bid premium separately. We obtain all our firm- and deal-level variables from the Thomson ONE database.

**Econometric method**

We proceed in two steps. First, we examine the initial acquisition premium, our main dependent variable of interest. We apply pooled least squares regressions like in previous research (e.g., Haunschild, 1994; Hope *et al.*, 2011; Laamanen, 2007). Second, we investigate the acquisition payment method and the toehold choice. Given the dichotomous nature of these variables, we use a probit model in both cases. In addition, following some previous studies (e.g., Rao and Drazi, 2002; Reuer, Tong, Tyler, and Ariño, 2013; Zellner, 1962), we evaluate the three dependent variables acquisition premium, cash, and toehold simultaneously using the seemingly unrelated regression (SUR) technique. The SUR model allows for correlated errors between equations.

In all specifications, we cluster errors at the country pair level. Descriptive statistics and cross-correlations of the variables included in the base model are provided in Table 1. There is no sign for multicollinearity.

*** Insert Table 1 about here ***

**RESULTS**

To begin with, we perform several statistical tests to examine the relationship between political affinity and the initial acquisition (or bid) premium. First, we observe that the simple correlation between political affinity and the initial acquisition premium is negative (-0.13) and statistically significant (*p < 0.01*). Second, we distinguish relatively friendly versus unfriendly country pairs
by separating country-dyads into two groups depending on the median value of political affinity. Cross-border deals involving relatively friendly countries exhibit, on average, a lower acquisition premium (M = 40.35; SD = 36.72) than deals between relatively unfriendly countries (M = 48.86; SD = 36.99). A t-test on the equality of the means of the acquisition premium for the two groups shows that the difference is statistically significant (p < 0.01). These results are confirmed by non-parametric tests. The Wilcoxon rank-sum test indicates a statistically significant difference in the distributions at the 1% level. The non-parametric test for equality of the median also reveals a significant difference (p < 0.01). Third, we explore to what degree changes in political affinity over time also lead to variation in acquisition premiums within a given country pair. We find that the negative relationship between political affinity and the initial acquisition premium is supported longitudinally. The correlation between political affinity and the initial acquisition premium within country pairs is again statistically significant (p < 0.01). Taking the sample of country pairs that experience a relative increase in political affinity between 1990-1999 and 2000-2008, we also observe that the initial acquisition premium is significantly lower (p < 0.05) in the latter period than in the former one.

We then investigate the relationship between political affinity and the initial acquisition premium more rigorously in a multivariate regression setting. In Table 2, we, in Model 1, first show the regression outcome comprising control variables only. The R-squared, albeit low at 11.6 percent, is similar to what can be found in the literature (Hope et al., 2011; Laamanen, 2007). We then augment this baseline model in Model 2 of Table 2 by adding the variable Political Affinity. As predicted in hypothesis 1, controlling for economic, cultural, political, and shareholder protection differences between the countries of the acquirer and the target firm, the variable Political Affinity is negative and significant (p < 0.01). Ceteris paribus, a higher level of
political affinity decreases the acquisition premium. Political affinity matters strongly also in terms of economic significance. A one standard deviation change in political affinity leads to a 5.1 percentage point reduction in the bid premium. This is important since the premium paid determines the cost of the acquisition and may in turn affect the performance of the deal and the success of the company.

*** Insert Table 2 about here ***

In the same Table 2, to confirm the robustness of our findings, we do several sensitivity checks in Models 3 to 10. First, to further check that our results are not driven by outliers, we trim political affinity by dropping observations corresponding to the largest and smallest 2 percent of political affinity in Model 3. Results are robust. Then, we replace our dependent variable, the initial bid premium, by the final bid premium in Model 4. The final bid premium reflects the outcome of the bargaining process started by the initial offer. It is also significantly and negatively affected by political affinity. In addition, following prior research (see e.g., Benner and Tushman, 2002; Phelps, 2010; Zelner, Henisz and Holburn, 2009) we also lag political affinity by one year in Model 5 to control for possible reverse causality issues. Results are again robust.\(^9\) In Model 6, 7 and 8 we add further control variables that could possibly explain the acquisition premium. In Model 6 we include two country-dyad level indicator variables that, respectively, take on the value one if the host and home countries have ratified a bilateral investment treaty (Source: UNCTAD) and are members to a common regional trade agreement (Source: De Sousa, 2012). We also add the difference of the natural logarithm transformed GDP between the home and host country to take into account power imbalance between countries (Source: WDI). “The best single indicator of a state’s power may be its total GDP, which

\(^9\) When lagging political affinity by two years, the result still holds.
combines overall size, technological level, and wealth” (Goldstein and Pevehouse, 2006: 57). In Model 7, similar to Rossi and Volpin (2004), we add three variables that could also account for the extent of proximity between countries, namely a common language, contiguity, and the intensity of bilateral trade. The variable common language and contiguity take on the value one if countries share the same official language and have a common border respectively and zero otherwise (source: CEPII). The intensity of bilateral trade is computed as the sum of export and import flows divided by the sum of GDP of the involved countries for each country pair (Source: Correlates of War Project Trade Data Set). All variables added in Models 6 and 7 are insignificant and do not change the political affinity outcome. In Model 8, we replace the country-level dyadic variables that capture the differences in the political system, shareholder governance, and economic development level with their respective host and home country values separately. Political affinity continues to reduce the initial bid premium. Finally, we focus on potential selection problems. Deals between country dyads with a low political affinity score might be deterred due to these bad relations. We follow Capron and Guillen (2009) and estimate the determinants of the number of acquisitions between two countries using a negative binomial regression model (results not shown, but available on request). This allows us to obtain the predicted number of acquisitions between country dyads. When including this predicted number of acquisitions as an additional regressor in Model 9, the variable is insignificant and political affinity still strongly affects the acquisition premium. Also, when focusing on cross-border deals, we do not consider the domestic alternative a target has when agreeing on being bought by a foreigner. Following Bris and Cabolis (2008) we, therefore, first match cross-border deals with similar domestic ones based on target firm and industry characteristics. We then take the

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10 Note that due to the high correlation between cultural distance and the common language indicator we need to exclude the former from this model.
difference between the premiums offered in these two deals as the dependent variable in Model 10. We find that a higher level of political affinity reduces the initial acquisition premium in cross-border relative to domestic deals, thus confirming our previous results.

*** Insert Table 3 about here ***

In Table 3, we report the findings for the seemingly unrelated regressions for the acquisition premium in Model 1, the toehold choice in Model 2, and the payment mode in Model 3 as the dependent variables. In all three models political affinity follows the predictions. A higher political affinity score decreases the premium offered and the likelihood that an acquirer will pay in cash, while it increases the propensity of using a toehold strategy. We check for the robustness of the results in Models 4 to 9. In Models 4 to 6 we winsorize the political affinity variable at 2 per cent and 98 per cent to control for possible outliers. In Models 7 to 9 we replace political affinity with its one period lagged value for considering possible reverse causality issues. The results remain robust in all models. Hypotheses 1 to 3 are supported. Political affinity significantly influences the bidding strategy of private non-financial firms in cross-border transactions.

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11 Similar to Bris and Cabolis (2008) we match deals using the following criteria: The deals are announced in the same year; the target firm belongs to the same industry (2-digit SIC code) and country; and the target firm in the domestic deal is the closest in terms of total assets to the target firm in the cross-border deal. We exclude deals where the matched transaction partners differ strongly in size.
SUPPLEMENTARY ANALYSES

Moderating role of the political context in the relationship between the acquisition premium and political affinity

In our supplementary analyses, our first objective is to understand more in depth the mechanisms through which political affinity affects cross-border acquisition deal-making. We focus on the moderating role of the political context in the target country on the relationship between political affinity and the acquisition premium, as the acquisition premium is the most important bidding parameter and features a large variation in outcomes. We present the results for the models when adding these moderators individually (Models 1 to 4) and when including them jointly (Model 5). We explore two different, but complementary dimensions of the political context, namely the host government environment and the domestic political connections of the target firm.

*** Insert Table 4 about here ***

Concerning the first dimension we analyze the relevance of government weakness and the extent of nationalism in a host country for political affinity effectiveness. Both have been found to influence government interventions against foreign acquisitions in general (Dinc and Erel, forthcoming). The political decisions that may influence a cross-border acquisition result from a trade-off for the host government between foreign policy and domestic interests (Putnam, 1988). While the host government desires to realize its foreign policy interests, it also has to take into account domestic arrangements. If political decision-making procedures limit governments in their ability to set policy outcomes, foreign policy objectives are more difficult to implement (Morgan and Campbell, 1991; Rogowski, 1999). In this regard, it has been argued that coalition governments are weaker (Dinc and Erel, forthcoming), since they face larger difficulties to find
consensus within the government for a coherent action agenda (Martin and Vanberg, 2003). A forward-looking acquirer is likely to consider the constraints the host government faces in exerting power in the domestic context and its ability to push through foreign policy interests. Therefore, the relationship between the initial acquisition premium and political affinity could be moderated by government weakness. We use government fractionalization (Source: Database of Political Institutions (DPI)) as a measure (Dinc and Erel, forthcoming). We find support in Model 1 and 5 in table 4 that it positively moderates the effect of political affinity.

Also, nationalist tendencies in a country should reduce the ability of a host government to provide help to foreign political friends. We measure nationalism with the share of votes of nationalist parties in a country’s parliament (Source: DPI). We find that, indeed, when the country is more nationalistic, foreign policy objectives weigh in lower. The effect of political affinity is reduced; foreign firms have to pay a relatively higher premium for a given level of political affinity (see the Models 2 and 5 in Table 4). Interestingly, we observe in the Models 3 and 5 that the moderating effect is reversed and becomes negative with a larger share of nationalists in a country’s government (Source: DPI). Once nationalists have a larger share of government control, foreign acquirers expect them to more closely consider political affinity when taking political decisions.

At a different level, foreign acquirers should expect host governments to be more likely to interfere in M&A transactions according to political affinity considerations when the target firm is politically connected. There is large evidence that firms can leverage political connections at their benefit (e.g., Faccio, 2006; Faccio, Masulis, and McConnell, 2006; Fisman, 2001). But, at the same time, politicians can also use these connections for advancing their political interests (Lenway and Murtha, 1994). Communication to the target firm might be easier and power
towards the target firm could be larger. The negative effect of political affinity on the premium could therefore be strengthened when political connections exist. To investigate this issue we use the data on politically connected firms collected by Faccio (2006) and available on the website of the American Economic Association, which identifies a firm as politically connected when a member of parliament, a minister, or someone closely related to a top politician or party is one of the large owners or a top officer of this firm.

We find evidence in Models 4 and 5 in Table 4 that political connections of the target firm reinforce the negative effect of political affinity. Our measure assumes that political connections remain persistent over time; firms that have a connection in 1997-2001 (the period used by Faccio (2006) for identifying political connected firms) are more likely to have some connection before and are also more likely to continue having one or get a new direct political connection later. Such an assumption is reasonable since the connections captured by Faccio (2006: 369) are described as relatively “durable”. Albeit a dramatic reduction in our sample size, the interaction term between the variables political connection and political affinity remains significantly negative if we use a shorter period of time (1994-2004) or the strict period 1997-2001. Results are available on request.

**Political affinity and stock market reaction to the deal**

The question also arises to what degree political affinity influences shareholder expectations towards the acquisition. To answer it, we apply the standard event study methodology. We calculate cumulative abnormal returns for each acquiring firm \( i \) for the three-day (-1,1) and five-day (-2,2) window around acquisition announcements. Assuming market efficiency, the abnormal returns provide an evaluation by the (stock) market of the value that is anticipated to be
created by the acquisition for the acquiring firm (Fama, 1970). The abnormal return for firm security $i$ at day $t$, cumulated over the event window, is the differential between the returns for security $i$ at day $t$ and the normal returns for firm $i$ at the same day $t$. Normal returns are obtained using the market model. We use a 250 trading day estimation window (-292, -43) following the existing literature. As market indices we use the local market indices as provided by Thomson Datastream. We then regress these abnormal returns on the list of explanatory variables, including political affinity. In Models 6 (three-day window) and 7 (five-day window) of Table 4, political affinity significantly increases the abnormal returns to the acquirer. Hence, the market perceives political affinity to be valuable for the acquiring firms, supporting our previous findings.

In sum, both managers, as observed in the bidding strategy, and shareholders of the acquiring firm, as revealed by their immediate reaction to the announcement of the deal, expect that a higher level of political affinity will be favorable to acquisitions in foreign markets.

**DISCUSSION AND CONCLUSION**

In this paper we examine the role of political affinity between countries in cross-border M&A deal-making. We find that the initial bid premium – the major strategic bidding component – decreases with a higher level of political affinity, controlling for a large set of variables, including cultural and other institutional differences between countries. We also observe that political affinity impacts the two other strategic bidding choices, i.e., the acquisition payment method and the establishment of a toehold. In a supplementary analysis we identify political contingency factors at the target and host government level. We also find that shareholders expect the foreign acquirer to gain from a higher level of political affinity, underlining the
empirical robustness of the result that political affinity has an impact on cross-border transactions. These findings point at the importance of international relations for cross-border deals.

We contribute to a small, but growing literature on international relations and foreign acquisitions in the following way. An abundant literature has explored the role of institutions in general and of the host country political environment in particular for business transactions (Boddewyn and Brewer, 1994; Delios and Henisz, 2003). In this research area a few studies have focused on protectionism and host government interventions against foreigners (Aktas et al. 2004; 2007; Dinc and Erel, forthcoming). Also, researchers have explained how firms can leverage their domestic political connections to modify to their advantage their local business environment (Faccio, 2006; Oliver and Holzinger, 2008). But, at a different level of analysis, little has been said about country-level bilateral political relations and how they can interfere with international business. Hence, while the distinction between domestic and foreign acquirers has been made to explain, for instance, government intervention (e.g., Dinc and Erel, forthcoming), the literature has only to a limited degree taken into account the heterogeneity of interstate relations for explaining the variation in political discrimination experienced by firms of different nationalities and its eventual impact on their business transactions.

This paper helps to fill this gap. We stretch the boundaries of previous macro-level work which found that international relations are important for country-level aggregated FDI (Li and Sacko, 2002; Li and Vashchilko, 2010) to decisions made by private non-financial companies in international deals. In this context we add to previous research on the bearing of multilateral or bilateral international agreements on international business (e.g., Ramamurti, 2001; Rangan and Sengul, 2009) by referring to political affinity. Political affinity captures the similarity in
preferences in global affairs of the host and home country and is a finer-grained and higher-order process that focuses on the willingness of governments to carry out cooperative or conflictual foreign policy actions. In the international relations literature the concept of political affinity was first developed by Gartzke (1998) as a construct to analyze the role of preferences of countries in militarized international disputes. We apply it to the international business setting and argue that, just as similarity in political preferences shape international political outcomes, it also affects government behavior in economic matters and is therefore likely to translate into a differing extent of political discrimination that foreign firms experience in the host market based on their nationality. While positive political affinity opens the door for economic cooperation, transactions of firms from less friendly countries are rendered more difficult.

Our research work complements very recent empirical studies by Knill et al. (2012) and Johan et al. (2013) which focus on SWFs and highlight that political affinity influences their foreign investments according to the state funds’ political motivations. We examine the strategic behavior of private non-financial firms and, contrary to these two studies, argue that political affinity can favorably affect the profit-maximization decisions of strategic acquirers. Strategic acquirers view a favorable political relation as creating strategic advantages. On top of that, we empirically identify moderators of the political affinity effect. We find that the effect of country-level bilateral political relations can be moderated by the domestic political connections of the target firm and the political context in which the host government is embedded. Political friendship is particularly important when a country’s environment is receptive to foreign policy issues.

Both our theoretical focus and empirical set-up differ from the papers that have been previously cited. In addition to highlighting political affinity as an underlying driver of “special
relationships” between countries, we examine strategic decisions that have been seldom analyzed in the field of IB. As a firm-level decision we decided to focus on the bidding behavior of the foreign firm. The bidding strategy of the acquirer reveals the bargaining position the acquirer anticipates to have during deal negotiations. Since Jemison and Sitkin (1986)’s seminal work, there has been a call for considering the acquisition process in more detail. But only a few studies have studied it (see, e.g., Finkelstein and Halebian, 2002; Muehlfeld, Rao Sahib, and Van Witteloostuijn, 2012), especially in the cross-border context (see, e.g., Dikova et al., 2010). Also, within strategic bidding choices, we put a strong emphasis on the initial bid premium since “[t]he most important of these offer parameters is the initial bid premium” (Eckbo, 2009: 150). In addition, acquisition premiums feature a large variation in outcomes and large acquisition premiums can have a disastrous impact on the acquisition performance (Haunschild, 1994). By showing that political affinity matters, we extend the small, but growing literature on premium antecedents in finance (Bris and Cabolis, 2008; Rossi and Volpin, 2004) and in strategy in general (Beckman and Haunschild, 2002; Hope et al., 2011; Kim, Halebian, and Finkelstein, 2011).

An important managerial implication from our results is that MNEs are not without grounding in global markets as firms retain a home nationality (Pauly and Reich, 1997). The world market is spiky and political friction can contribute to these spikes. Consequently, firms seeking to expand abroad should closely examine the bilateral political aspect of the international deal. They should incorporate not only the political situation in the target country, but also the dyadic relationship between the home and host countries.

As in other studies there are limitations to our paper, offering avenues for future research. For instance, our sample consists of listed targets and thereby of large target and acquiring firms.
The sample selection of deals with publicly listed firms certainly helps in reducing the possibility of a spurious relationship between political affinity and strategic bidding choices since these firms are highly visible and deals are likely to be well advertised. Consequently, these acquisitions have a higher probability to attract the attention of governments. On the other hand, this sample selection limits generalizability as we do not include small transactions. Also, in our analysis, due to data constraints, we neglect the role of diplomacy. When relations are friendlier, diplomatic representations could operate more smoothly (Neumayer, 2008) as diplomats’ phone calls are more likely to be returned and access to political and business networks is wider and faster. Publicly available data, however, on diplomatic representation (Bayer, 2006) only accounts for the presence of general diplomatic ties, but do not capture the nature and intensity of diplomatic exchanges. Moreover, during the period we study, all our sample countries already have some diplomatic representation in the partner country.
REFERENCES


Table 1: Summary statistics and correlations

<table>
<thead>
<tr>
<th>VARIABLES</th>
<th>INITIAL ACQUISITION PREMIUM</th>
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<th>DIFFERENCE IN POLITICAL SYSTEMS BETWEEN COUNTRIES</th>
<th>CULTURAL DISTANCE</th>
<th>DIFFERENCE IN SHAREHOLDER PROTECTION BETWEEN COUNTRIES</th>
<th>DIFFERENCE IN GDP PER CAPITA BETWEEN COUNTRIES</th>
<th>DIFFERENCE IN SIZE BETWEEN ACQUIROR AND TARGET</th>
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<th>TARGET ROA</th>
<th>ACQUIROR DEBT RATIO</th>
<th>TARGET DEBT RATIO</th>
<th>ACQUISITION EXPERIENCE</th>
<th>STAKE Sought</th>
<th>COMPLETED DEAL</th>
<th>MULTIPLE BIDDERS</th>
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<th>HOSTILE ACQUISITION</th>
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</table>
Table 2: The effect of political affinity on the acquisition premium

<table>
<thead>
<tr>
<th>Variable</th>
<th>Model 1 Model 2 Model 3 Model 4 Model 5 Model 6 Model 7 Model 8 Model 9 Model 10</th>
</tr>
</thead>
<tbody>
<tr>
<td>Difference in Political Systems between Countries</td>
<td>1.060 0.862 0.839 -0.219 0.919 1.009 0.913 0.812 0.295</td>
</tr>
<tr>
<td>Cultural Distance</td>
<td>-0.251 0.428 1.121 0.670 29 0.249 0.549 0.680 0.331 0.768</td>
</tr>
<tr>
<td>Difference in Shareholder Protection between Countries</td>
<td>-1.022 -0.988 -1.081 -0.342 -0.963 -0.728 -1.048 -1.028 -2.103</td>
</tr>
<tr>
<td>Difference in GDP per Capita between Countries</td>
<td>2.669 4.093 2.802 4.541* 3.751 3.651 4.120* 4.180* 5.973**</td>
</tr>
<tr>
<td>Difference in Size between Acquirer and Target</td>
<td>1.110 1.149 0.277 0.910 1.180 1.210 1.074 1.139 1.309 -1.044</td>
</tr>
<tr>
<td>Acquisition Experience</td>
<td>-0.0551 -0.0837 0.0989 0.191 -0.0668 -0.0542 0.0321 -0.0515 -0.138 -0.247</td>
</tr>
<tr>
<td>Stake Sought</td>
<td>0.467** 0.410*** 0.427*** 0.383** 0.418** 0.409** 0.401*** 0.378** 0.412*** 0.190</td>
</tr>
<tr>
<td>Completed Deal</td>
<td>14.10** 13.38** 11.47** 11.97** 13.35** 13.50** 14.01*** 13.68** 11.67** 13.94</td>
</tr>
<tr>
<td>Multiple Bidders</td>
<td>17.51*** 17.44*** 11.12** 19.17*** 17.49*** 17.52*** 18.20** 17.57*** 16.03*** 18.72***</td>
</tr>
<tr>
<td>Tender Offer</td>
<td>6.289* 7.597** 8.923** 10.17*** 7.244** 7.598* 7.620** 7.739** 7.624** 5.007</td>
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<tr>
<td>Hostility Acquisition</td>
<td>-2.433 -1.255 -2.325 -1.993 -1.036 -1.469 -1.619 -1.499 -2.562 -6.841</td>
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<tr>
<td>Horizontal Acquisition</td>
<td>-1-0-0-2 0.162 0.119 0.120 0.112 0.120 0.120 0.120 0.129 0.129</td>
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<tr>
<td>Political Affinity (Trimmed value - 2 %)</td>
<td>-15.33** -12.60*** (4.008)</td>
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<tr>
<td>Political Affinity (t-1)</td>
<td>-1.065 (0.756)</td>
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<tr>
<td>Power Imbalance</td>
<td>0.277 (0.697)</td>
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<tr>
<td>BIT Effectiveness</td>
<td>-6.308 (11.58)</td>
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<tr>
<td>Regional Trade Agreement</td>
<td>2.827 (2.355)</td>
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<tr>
<td>Common Language</td>
<td>-2.643 (3.066)</td>
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<tr>
<td>Contiguity</td>
<td>-0.705 (8.115)</td>
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<tr>
<td>Bilateral Trade Intensity</td>
<td>147.3 (272.6)</td>
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<tr>
<td>Home Country Political System</td>
<td>-1.065 (0.756)</td>
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<tr>
<td>Host Country Political System</td>
<td>-0.448 (1.579)</td>
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<tr>
<td>Home Country Shareholder Protection</td>
<td>-0.428 (2.348)</td>
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<tr>
<td>Home Country GDP per Capita</td>
<td>5.140* (2.707)</td>
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<tr>
<td>Host Country GDP per Capita</td>
<td>0.355 (5.590)</td>
</tr>
<tr>
<td>Predicted Number of M&amp;A</td>
<td>-0.00812 (0.203)</td>
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<tr>
<td>Observations</td>
<td>726 715 616 712 707 715 707 715 692 532</td>
</tr>
<tr>
<td>R-squared</td>
<td>0.116 0.127 0.124 0.118 0.120 0.129 0.128 0.129 0.121 0.090</td>
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</tbody>
</table>

*** p<0.01, ** p<0.05, * p<0.1
Sector and year fixed effects are included in each regression.
We cluster errors at the country pair level.
Table 3: The effect of political affinity on the toehold choice and payment mode

<table>
<thead>
<tr>
<th>Model 1</th>
<th>Model 2</th>
<th>Model 3</th>
<th>Model 4</th>
<th>Model 5</th>
<th>Model 6</th>
<th>Model 7</th>
<th>Model 8</th>
<th>Model 9</th>
</tr>
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<tbody>
<tr>
<td>Premium</td>
<td>Toehold</td>
<td>Cash</td>
<td>Premium</td>
<td>Toehold</td>
<td>Cash</td>
<td>Premium</td>
<td>Toehold</td>
<td>Cash</td>
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<tr>
<td>Trained value</td>
<td>Trained value</td>
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</tr>
</tbody>
</table>

Difference in Political Systems between Countries
-0.00702
-0.00186

Cultural Distance
-0.0841
-0.0845

Difference in GDP per Capita between Countries
0.0125

Lagged variable
0.0150

Difference in Shareholder Protection between Countries
-0.00585

Difference in Size between Acquiror and Target

Acquiror ROA
-0.431

Difference in GDP per Capita between Countries
0.0128

Acquiror Debt Ratio
0.0125

Completed Deal
1.372

Multiple Bidders
0.0127

Horizontal Acquisition
-0.0251

Political Affinity
-0.00694

Political Affinity (Trimmed value - 2 %)
0.0906***

Observations
707

*** p<0.01, ** p<0.05, * p<0.1

Sector and year fixed effects are included in each regression.

We cluster errors at the country pair level.
Table 4: Supplementary analyses: Political contingency factors; Stock market reaction

<table>
<thead>
<tr>
<th>Model 1</th>
<th>Model 2</th>
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<th>Model 4</th>
<th>Model 5</th>
<th>Model 6</th>
<th>Model 7</th>
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<tbody>
<tr>
<td>Difference in Political Systems between Countries</td>
<td>0.825</td>
<td>0.782</td>
<td>0.833</td>
<td>0.838</td>
<td>0.771</td>
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<td>Cultural Distance</td>
<td>0.754</td>
<td>0.380</td>
<td>0.422</td>
<td>0.586</td>
<td>0.800</td>
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<td>Difference in Shareholder Protection between Countries</td>
<td>-1.548</td>
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<td>-1.195</td>
<td>-1.032</td>
<td>-2.055</td>
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<tr>
<td>Difference in GDP per Capita between Countries</td>
<td>4.841**</td>
<td>4.361*</td>
<td>3.968*</td>
<td>4.023*</td>
<td>5.139***</td>
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<td>Difference in Size between Acquiror and Target</td>
<td>1.122</td>
<td>1.245</td>
<td>1.185</td>
<td>1.067</td>
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<td>-10.45</td>
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<td>0.411***</td>
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<td>Completed Deal</td>
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<td>Nationalist Party Government Vote Share</td>
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<td>(3.513)</td>
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<td>(4.098)</td>
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*** p<0.01, ** p<0.05, * p<0.1
Sector and year fixed effects are included in each regression. We cluster errors at the country pair level.
## APPENDIX

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