FAYETTEVILLE, Ark. – Stockholders in companies undertaking cross-border mergers will probably see the value of their stock drop, according to University of Arkansas researchers Tommy Carnes and Tomas Jandik. Although there was a 500 percent increase in cross-border mergers and acquisitions during the 1990s, research indicates that this has not been beneficial to shareholders.

“American companies that buy foreign companies find it usually doesn’t work – the companies don’t do well on return on investment and the stock price goes down,” explained Carnes, assistant professor of accounting.

Carnes and Jandik, assistant professor of finance, conducted their study along with Ervin Black of Brigham Young University. Their results were presented recently at the American Accounting Association Globalization Conference in Berlin.

The researchers examined results for 361 U.S. companies acquiring foreign targets in 17 countries between 1985 and 1995. Target companies were primarily in the United Kingdom (24 percent), Canada (20 percent), France (15 percent) and Germany (11 percent).

Although globalization and deregulation made these deals easier to complete, most research has focused on the few days surrounding the announcement of the merger.
found “significant” positive return in the days immediately following a merger announcement, by the one-year mark, returns were “significantly negative.” After that, losses were so common as to almost be predictable.

“We looked at long-term results,” explained Carnes. “We found that at both the three-year and five-year points, cross-border mergers were a value-destroying activity.”

Typically, companies seek to expand through cross-border mergers either to penetrate a foreign market or as a hedge against risk. This diversification is seen as a way to smooth income streams and protect against economic declines.

“The theory is that not all countries go into recession at the same time,” Carnes explained. “But both management and investors underestimate the difficulty of cross-border mergers.”

Research into cross-border mergers is more difficult because of the complications inherent in foreign generally accepted accounting principles (GAAP). According to the researchers, these difficulties make it even less likely that cross-border mergers can add value for shareholders.

Initially, the researchers speculated that differences in accounting practices could impact perceived shareholder value. Because accounting practices in some countries are very different from those in the U.S., they hypothesized that it would make it difficult for U.S. firms to accurately assess the value of foreign firms. This should lead to proportionally greater losses from mergers with companies in these countries.

However, when researchers grouped the target companies according to accounting methods of their home country, the results were opposite to their expectations. While both subgroups showed negative returns, mergers with targets in countries with GAAP similar to the U.S. produced bigger losses. They suggest that this may be a result of higher cost of capital in those countries.

The researchers conclude that, “in the majority of instances, expansion of U.S. firms through acquisition of foreign targets is a value-destroying activity.” While Carnes characterizes this as “pretty widely known” in the financial industry, adding that, “why managers of U.S. companies undertake such value-destroying events is a topic for future research.”