Journal of Economics and Public Finance
ISSN 2377-1038 (Print) ISSN 2377-1046 (Online)
Vol. 11, No. 1, 2025
www.scholink.org/ojs/index.php/jepf

Original Paper

The Impact of Legal Systems on the Equity Choices of Cross-border Merger and Acquisition by Chinese Enterprises: An Empirical Study Based on RCEP Member Countries

Gengtao Tu[1*]

[1] School of Economics, Guangxi University, Nanning, Guangxi, China

[*] Corresponding author

Received: November 2, 2024 Accepted: December 20, 2024 Online Published: December 26, 2024

doi:10.22158/jepf.v11n1p1 URL: http://dx.doi.org/10.22158/jepf.v11n1p1

Abstract

There has been extensive research on cross-border mergers and acquisitions (M&A), but relatively few studies have addressed the issue of equity selection; the influence of legal system has also been overlooked. This study aims to deepen the understanding of corporate cross-border M&A by exploring whether and when legal system affects equity selection in cross-border M&A. Based on institutional theory, this study constructs models and finds that legal system positively influences corporate cross-border M&A equity decisions. This study further discovers that legal advisors and financial advisors weaken the positive impact of legal system on corporate cross-border M&A equity decisions. This paper extends the existing research on the impact of legal system on corporate market strategies. This is achieved by innovatively expanding the consequences of legal system to equity selection in companies' cross-border M&A. Legal system is an important and underexplored topic in the field of international trade. Additionally, this paper enriches the existing research on legal system at the micro-level of enterprises, providing new theoretical foundations for firms in emerging economies to engage in cross-border M&A activities.

Keywords

Legal system; Cross-border merger and acquisition (M&A); Legal advisor; Financial advisor

1. Introduction

Cross-border mergers and acquisitions (M&A) stand as a significant pillar of outward foreign direct investment. In 2021, China's actual transaction volume of outward investment and M&A soared to $31.83 billion, marking a noteworthy 12.9% year-on-year increase from the previous year. Chinese

enterprises collectively embarked on 505 outward investment and M&A endeavors, spanning 59 countries and regions. Cross-border M&A not only epitomize a critical facet of outward foreign direct investment, but they also serve as a pivotal conduit for enterprises to expand their global footprint (Buckley, 2019). As academic discourse on cross-border M&A burgeons, scholars predominantly delve into the nuances of location selection, i.e., where to buy, acquisition targets, i.e., what to buy, and the motivations underlying M&A, i.e., the reasons to buy. Nevertheless, academia has yet to furnish a comprehensive elucidation on the optimal equity proportion in M&A, i.e., how much to buy (Ahammad et al., 2018; Ming et al., 2019).

The magnitude of equity acquisition in M&A delineates the commitment of enterprise resource allocation, risks, and potential returns (Chen and Hennart, 2004). Throughout the course of cross-border M&A, enterprises may harbor trepidations concerning the substantial but necessary resource commitment, elevated search costs, and evaluation costs associated with holding more equity in an unfamiliar milieu. They may thereby forego the strategic high-intensity control over the target company that would be engendered by acquiring more equity (Chari and Chang, 2009). Enterprises often mitigate information asymmetry and curtail M&A risks. This is done by attenuating the proportion of equity in M&A, albeit accompanied by the accretion of governance costs and protracted learning curves over time (Chen and Hennart, 2004). In the journey of Chinese enterprises "going global," the art of effectively balancing the dynamics of disadvantages and the power, risks, and benefits stemming from equity acquisitions demands a nuanced consideration of myriad factors encompassing national, industry-specific, and corporation. Of particular significance are the host country's nuanced economic, political, cultural, and institutional landscapes; these factors collectively shape enterprises' multinational M&A strategies (Chari and Chang, 2009). Yet, scholarly exploration into the legal systems of the countries that acquire entities and those that target entities as the linchpin of research remains sparse.

Since the 1998 seminal work "Law and finance" by La Porta and collaborators, an escalating cadre of scholars has been scrutinizing the ramifications and impacts of legal systems on finance, economics, and corporate comportment. The burgeoning interdisciplinary interface between law and economics underscores the pivotal role of legal systems in shaping the economic milieu (Porta et al., 2008). Extant literature has delved into the national-level repercussions of legal systems, encompassing facets such as economic growth (Porta et al., 2008), financial evolution (De Vita et al., 2020), and foreign capital ingress (Yupeng et al., 2011). Additional explorations have extended to the corporate realm, encapsulating corporate environmental stewardship (Kim et al., 2017) and corporate social responsibility (Becchetti et al., 2020), alongside individual-level implications including CEO discretionary power (Crossland and Hambrick, 2011) and CEO financial holdings (Yeoh and Hooy, 2022). Nonetheless, the corpus of research has largely skirted around the impact of legal systems on strategic deliberations within the context of cross-border corporate M&A. Rooted in the tenets of institutional theory, as institutional bedrocks, legal systems wield substantial influence on corporate

comportment (Addi and Abubakar, 2022). Corporate conduct must harmonize with institutional norms, in order to accrue external legitimacy (Berry et al., 2010). Wide disparities in legal systems between two countries precipitate formidable challenges for multinational enterprises. These disparities include but are not limited to legitimacy deficits and information asymmetry, which culminate in escalated overseas operational costs and a marginalized outsider stance. Hence, one must not discount the impact of legal systems on strategic decision-making in the realm of corporate cross-border M&A.

In exploring the impact of legal systems on corporations' cross-border M&A, this study opts to analyze acquisition events undertaken by Chinese enterprises within Regional Comprehensive Economic Partnership (RCEP) member countries. The RCEP comprises 10 ASEAN nations and four developed economies, namely Japan, South Korea, New Zealand, and Australia. The decision to focus on empirical research within RCEP member countries is underpinned by several considerations. Firstly, these countries have become promising arenas for Chinese enterprises seeking cross-border M&A prospects, including both emerging and advanced economies. Secondly, given the varying legal frameworks and doctrines, the diverse legal systems across RCEP member countries necessitate a meticulous approach during cross-border M&A endeavors. Lastly, analyzing M&A events within RCEP member countries aids in attenuating the potential impact on such transactions of divergent clauses within regional trade pacts (Baier et al., 2019).

In contrast with existing literature, this paper contributes in three significant dimensions by bridging the realms of law and economics. Firstly, this research enhances the understanding of the factors that influence equity selection in cross-border M&A. This is achieved by introducing the pivotal variable of legal systems, thereby advancing research on internationalization entry modes. The legal systems delineated in this paper emerge as an indispensable new facet, broadening the spectrum of considerations that influence cross-border M&A. The legal systems go beyond mere metrics like firm size, cultural disparities, and business milieu (Chari and Chang, 2009). Within the arena of corporate cross-border M&A endeavors, the information asymmetry, entry costs, and perceived risks stemming from the divergent legal systems of both the acquiring and target firms significantly shape decisions regarding equity acquisition. Leveraging micro-level data, this paper expands insights into the impact of legal systems on the market, while delineating the market's contextual boundaries.

Secondly, the results extend the ramifications of legal systems to the realm of equity selection in cross-border M&A. This research buttresses the notion posited by La Porta and colleagues, namely that legal systems wield a pivotal influence on the economy. Despite burgeoning interest in legal systems across the Western sphere, studies integrating the impact of legal systems into corporate cross-border M&A strategic decisions remain relatively scarce. Existing literature has predominantly scrutinized the impact of legal systems at national (Porta et al., 1998), corporate (Kim et al., 2017), and individual levels (Yeoh and Hooy, 2022). At corporate level, the focus thus far has been on legal systems' influence on non-market strategies, such as corporate social responsibility (Becchetti et al., 2020) and corporate environmental responsibility (Kim et al., 2017). This paper endeavors to analyze

enterprise-level data, thereby amplifying previous research on the impact of legal systems on corporate market-oriented strategies.

Thirdly, the current research complements and enriches the exploration of micro-level enterprises engaging in cross-border M&A from the prism of legal systems. This study unravels the tangled intersection between law and finance theories in socialist and transitional economies (Pistor et al., 2000) and furnishes empirical evidence from China for legal systems research. Prior studies have predominantly fixated on legal systems in developed nations across Europe and the United States. By shifting the focus to enterprises from emerging economies and harnessing M&A data from developing nations, this paper extrapolates more targeted and pragmatically significant conclusions. The results and conclusions offer guidance for emerging economy enterprises eyeing participation in cross-border M&A.

2. Theory and Hypotheses

2.1 Legal System

Each nation boasts its own legal framework, and each is distinguished by unique attributes. Yet, intriguingly, these frameworks demonstrate parallels in certain foundational aspects (Yupeng et al., 2011). Legal systems across the globe predominantly stem from common law and civil law traditions. The genesis of these legal systems can be traced back to the 19th century, when, amidst territorial expansion, European colonial powers, transplanted their legal paradigms into regions under their control (La Porta et al., 2002). For instance, Britain propagated its common law system to territories spanning North America, South Asia, East Africa, and Oceania. Today, countries such as the United Kingdom, the United States, Australia, and Singapore epitomize the legacy of common law traditions.

Conversely, France's civil law system underwent refinement during the Napoleonic era and was widely adopted across the European continent during Napoleon's reign. During the era of French colonialism, France’s laws were subsequently introduced to regions like North Africa, Southeast Asia, and Latin America. On the one hand, common law predominantly relies on layperson judgments, with legal principles serving as ancillary aids, accentuating courtroom advocacy and the evolution of legal doctrines. On the other hand, civil law places greater reliance on professional judges, strictly adhering to legal statutes and documented records (Glaeser and Shleifer, 2003). Fundamentally, common law embodies the societal control ideology that supports outcomes within private markets (Klerman et al., 2011). Meanwhile, civil law upholds the state's role in resource allocation (Porta et al., 2008).

Overall, countries with common law system foundations typically feature market-driven financial systems with minimal governmental intervention. Such countries offer more robust protection for foreign investors, compared to these countries’ civil law counterparts (Porta et al., 2008). Common law jurisdictions prioritize safeguarding minority shareholder rights, ensuring creditor protection, and fostering transparency in information disclosure. These legal features cultivate a more stable business environment (Porta et al., 1998) and render such countries and regions more attractive to businesses

(Paul and Jadhav, 2019). Consequently, holding a larger equity stake in countries rooted in common law implies that investors face lower risks and can potentially reap higher returns, albeit while making substantial resource commitments.

2.2 Legal System and Choice of Equity in Cross-border M&A

Based on the preceding analysis, jurisdictions under common law system tend to feature more sophisticated financial frameworks, providing robust protection for foreign investors and nurturing favorable business environments. These areas thus position themselves as prime destinations for Chinese enterprises seeking to expand internationally. Consequently, Chinese enterprises should contemplate acquiring a greater share of equity in countries with common law roots. However, the reality presents a different scenario. China's legal system is imbued with socialist legal principles that are unique to the country’s societal structure. During the nascent stages of formulating its legal framework, China drew heavy inspiration from the Germanic civil law traditions. As a result, China's legal heritage aligns with civil law. Within the realm of cross-border M&A, the influence of legal systems is as profound as cultural and linguistic disparities. As an offshoot, nations sharing similar legal systems encounter substantially fewer barriers in trade relations.

In nations with divergent legal systems, enterprises embarking on cross-border mergers and acquisitions typically and frequently encounter information asymmetry. Civil law-based jurisdictions typically possess authoritative codes and detailed legal provisions; their essential legal articles can be comprehended through language translation. In contrast to the reliance on courtroom arguments and case law interpretation prevalent in common law, civil law-based countries find it easier to grasp each other's legal systems and adapt to each other’s legal environments. Conversely, enterprises hailing from civil law backgrounds may face information asymmetry when navigating M&A in common law jurisdictions (Jandik and Kali, 2009). Hence, Chinese enterprises may opt to acquire a smaller equity stake in less familiar, common law-based nations.

Secondly, in nations with divergent legal systems, enterprises encounter elevated learning costs during trade engagements. The divergence in legal systems also signifies disparities in national legal systems and institutional frameworks. This underscores the transactional costs that enterprises must account for in cross-border M&A. When Chinese enterprises pursue cross-border M&A in jurisdictions sharing a common legal system, both parties prioritize formal procedures and rely on professional adjudicators (Yupeng et al., 2011). This approach fosters heightened acceptance and displays an adaptability to the legal milieu of the host country. Consequently, enterprises find it easier to grasp the "rules of the game", and they incur diminished learning costs throughout the M&A process. Conversely, the wider the gap in legal systems is, the more daunting it becomes for both parties to assimilate the other's legal norms. This renders M&A more challenging and necessitates protracted governance costs and cycles. In these cases, enterprises may opt to hold fewer shares as a means to mitigate the learning costs associated with market entry.

Lastly, in nations with differing legal systems, decision-makers within enterprises perceive heightened

risks throughout cross-border mergers and acquisitions. On the one hand, mergers within countries that share a common legal system frequently benefit from similar legal regulations. This legal environment facilitates enterprises' swift adaptation to the host country's legal framework and empowers decision-makers to better discern risk factors inherent in the cross-border M&A process (Chittoor et al., 2015), thus mitigating risks to some extent. On the other hand, conducting cross-border M&A in host countries with distinct legal systems exposes decision-makers to amplified risks stemming from information asymmetry. They also face the challenge of swiftly adapting to divergent legal landscapes. To mitigate this informational gap and to minimize risks, decision-makers may opt for collaborative merger strategies, such as partnering with local enterprises in the host country. They may also opt to reduce the proportion of merger shares. These strategies help decision-makers swiftly comprehend and navigate the legal intricacies of the host country, overcome entry barriers, and adapt to evolving business ecosystems (Chittoor et al., 2015; Sun et al., 2017).

In general, when Chinese enterprises engage in trade with countries that share the same civil law system, as the outsiders, the Chinese enterprises encounter lower learning costs and have higher adaptability and smaller disadvantages; they also perceive fewer risks. Therefore, in civil law countries, Chinese enterprises are more inclined to invest more capital and acquire a greater share, even up to 100% full acquisition. Conversely, when conducting trade in countries with different legal systems, Chinese enterprises must face unfamiliar legal environments and incur higher learning costs. Decision-makers perceive greater risks, and thus, decision-makers in M&A typically opt to reduce the proportion of merger shares, in order to mitigate information asymmetry and alleviate insecurity.

Therefore, Hypothesis 1 is proposed:

H1: When engaging in cross-border M&A, compared to civil law system host countries, Chinese enterprises tend to acquire fewer shares in enterprises based in common law system host countries.

2.3 The Moderating Effect of Legal Advisers and Financial Advisers

As previously analyzed, the correlation between legal system and the proportion of shares in corporate M&A has been clearly elucidated. This study is thus prompted to contemplate methods that could be used to diminish the influence of legal system disparities on cross-border corporate M&A. Engaging professional consultants appears to be a prudent decision. For example, employing legal advisors and financial consultants during cross-border M&A can safeguard shareholders' legal rights and interests while ensuring the seamless execution of such transactions.

2.3.1 The Moderating Effect of the Legal Advisors

Legal advisors are equipped with specialized legal knowledge, and they conduct thorough investigations into merger targets. This gives them insights into the legal systems of the target companies' host countries. Legal advisors can therefore assist companies in mitigating legal risks by offering professional legal advice regarding acquiring entities, overcoming merger hurdles, reducing cross-jurisdictional learning costs, and enhancing shareholder value (Westbrock et al., 2019). Engaging legal advisors also helps to facilitate information disclosure by the target company (Amiram et al.,

2018), thereby diminishing the acquiring firm's perceived risk due to information asymmetry. After the merger occurs, legal advisors play a role in resource integration within the company, offering optimal resource allocation advice from a legal standpoint. This increases merger success rates (Krishnan and Masulis, 2013) and reduces the likelihood of merger failure and "poor digestion" (subpar post-merger performance). In essence, by hiring legal advisors, Chinese companies can mitigate the learning costs associated with acquisitions in common law countries, alleviate information asymmetry, and reduce perceived risks for decision-makers.

Therefore, Hypothesis 2a is proposed:

H2: Compared to not hiring legal advisors, engaging legal advisors weakens the impact of legal system differences on equity selection in companies' cross-border M&A.

2.3.2 The Moderating Effect of the Financial Advisers

When conducting acquisitions in countries with different legal systems, financial advisors also play a significant role. For one thing, financial advisors possess specialized expertise in financial instruments, capital markets, and transaction structures, enabling them to provide tailored services to acquiring entities. These services include but are not limited to conducting thorough financial due diligence on merger targets, negotiating deals, and overseeing equity delivery (Huang et al., 2024). Before the merger, financial advisors conduct in-depth investigations into the business environment, management practices, and business philosophies of the target merger entities. They then devise comprehensive merger plans (Graham et al., 2017), which include assisting the acquiring entities to obtain crucial merger-related information, mitigating the impact of information asymmetry, and reducing learning costs (Song et al., 2013). Throughout the merger process, financial advisors offer valuable guidance on negotiation strategies and contract execution, thereby facilitating the smooth progression of the merger. Post-merger, financial advisors provide expert insights into integration, consolidation, merger performance, and corporate development (Bi and Wang, 2018; Lassala et al., 2016), enabling the acquiring entity to optimize resource allocation and minimize the risk of merger failure.

Furthermore, financial advisors engaged in international affairs possess a nuanced understanding of both civil law and common law business environments. Common law systems typically provide greater protection for foreign investors, with less intervention from host country governments. Financial advisors communicate these nuances to decision-makers, alleviating their perceived risks and encouraging a more favorable attitude towards acquiring greater equity in enterprises based in common law countries. Common law countries generally offer stronger protections for foreign investors, providing more developed financial markets and safer business environments. Motivated by their commitment to client interests or their track record of success with acquiring entities (Lassala et al., 2016), financial advisors are inclined to recommend that acquiring entities acquire larger stakes in common law countries. In summary, financial advisors can help mitigate financial information asymmetry, reduce perceived risks for decision-makers, and increase the shareholding of acquiring entities in common law countries during mergers.

Therefore, Hypothesis 2b is proposed:

H3: Compared to not hiring financial advisors, engaging financial advisors weakens the impact of legal system differences on equity selection in companies' cross-border M&A.

Figure 1 is the analytical framework of legal system and M&A equity.

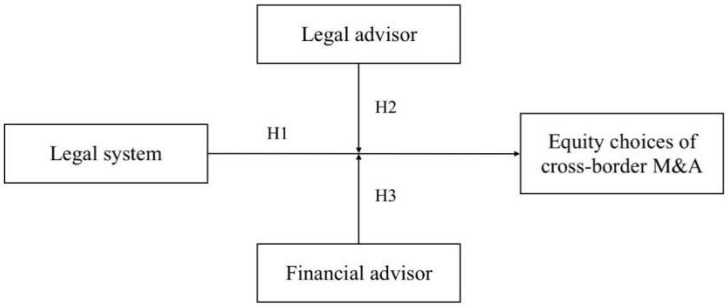

Figure 1. The Analytical Framework of Legal System and M&A Equity

3. Method

3.1 Sample and Data

This paper selects data related to cross-border M&A by Chinese listed companies as the research subject. The sample comprises M&A events in which the acquiring party is a mainland Chinese company, and the target is a company in an RCEP member country. The total sample comprises 196 listed companies and 292 M&A events. The data are sourced from the Securities Data Corporation (SDC) global M&A database. In the sample selection process, following the methods used in relevant cross-border M&A literature, the following data processing steps were taken (Zhang et al., 2019; Huang et al., 2017): (1) Only completed M&A events were included. (2) All M&A events with missing transaction values or M&A equity ratio information were excluded. (3) All M&A transactions with equity ratios below 5% were excluded, in order to avoid cases of portfolio investment. (4) Only the initial M&A of the acquiring company with the target company, i.e., fresh acquisitions, have been retained. (5) To eliminate the interference of extreme values on the results, all variables were trimmed at the 1st and 99th percentiles. After the above steps were taken, a total of 93 cross-border M&A transactions implemented by Chinese companies in RCEP member countries, from 2003 to 2022, were obtained.

3.2 Measures

3.2.1 Cross-border M&A Equity Stake (Share)

In this paper, "Share" is the dependent variable, representing the equity stake obtained by the acquirer in a cross-border M&A transaction upon completion. The measurement adopted in this study is the proportion of equity held by the acquirer in the target company after the merger or acquisition (Manli et al., 2017; Ming et al., 2019).

3.2.2 Legal System of the Target Country (Legal System)

In this study, "Legal System" is the explanatory variable, where the legal system of the target country is

designated as a dummy variable (Kim et al., 2017). For the purpose of this study, the target country's legal system is classified as either Common Law (1) or Civil Law (0). Among the sampled RCEP member countries, those with a Civil Law system designation include Vietnam, Laos, Cambodia, Indonesia, the Philippines, Thailand, Japan, and South Korea. Alternatively, countries such as Malaysia, Singapore, Myanmar, Brunei, Australia, and New Zealand are classified as Common Law.

Vietnam, Laos, and Cambodia were formerly French colonies, while Indonesia was under Dutch colonial rule, and the Philippines was once a Spanish colony. Influenced by their colonial powers, these countries adopted the civil law legal system upon gaining independence, thus falling under the civil law legal origin. Although Thailand was never colonized, it served as a buffer state between British India and French Indochina. However, Thailand's legal system primarily relies on written law, leading to its classification under civil law legal origin. When establishing modern legal frameworks, Japan and South Korea borrowed heavily from the German civil law tradition, placing them under the category of German civil law legal origin. Malaysia, Singapore, and Myanmar were once under British colonial administration, while Brunei was compelled to become a British protectorate, while Australia and New Zealand were part of the British Commonwealth. These six nations were deeply influenced by British common law and have thus been categorized under the common law legal origin.

3.2.3 Legal Advisor

This variable serves as a moderating variable, measuring whether the acquirer has engaged a legal advisor (Westbrock et al., 2019). If the acquirer has hired a legal advisor, the acquirer is coded as 1; otherwise, 0.

3.2.4 Financial Advisor

This variable serves as a moderating variable and assesses whether the acquirer has engaged a financial advisor (Chang et al., 2016). If the acquirer has hired a financial advisor, the acquirer is coded as 1; otherwise, 0.

3.2.5 Other Control Variables

Market value size: This variable is measured as the natural logarithm of the market value of the enterprise, plus 1. Enterprise age: This variable is measured as the natural logarithm of the actual years since the enterprise was listed, plus 1. State owned enterprise (SOE): This is a dummy variable, where state-owned enterprises are coded as 1 and non-state-owned enterprises are coded as 0. Firm performance: This is measured using the total asset profit rate. R&D intensity: This variable is represented by the ratio of research and development expenses to operating income. Advertising intensity: This variable is represented by the ratio of advertising expenses to operating income. Industry competition level: This variable is measured as 1, minus the square of the sum of the market share of all listed companies in the industry.

Additionally, annual dummy variables (YEAR) and industry dummy variables (INDUSTRY) are introduced to control for annual trend changes and industry-specific differences. Data for these control variables are sourced from the CSMAR database and the WIND database.

3.3 Modeling

Because the dependent variable (the equity stake proportion of the target company in M&A transactions) is bounded between 0 and 1, using ordinary least squares (OLS) for regression coefficient analysis can lead to biased and inconsistent parameters. The Tobit model, also known as the censored regression model, which is based on maximum likelihood estimation, is used to prevent such occurrences.

$$Share_{i,t} = \alpha_0 Legal_i + \alpha_i Controls_{i,t} + YEAR + INDUSTRY + \varepsilon_{i,t} \quad (1)$$

$$Share_{i,t} = \beta_0 Legal_i + \beta_1 LegalA_{i,t} + \beta_2 Legal_i \times LegalA_{i,t} + \beta_i Controls_{i,t} + YEAR + INDUSTRY + \varepsilon_{i,t} \quad (2)$$

$$Share_{i,t} = \gamma_0 Legal_i + \gamma_1 FinancialA_{i,t} + \gamma_2 Legal_i \times FinancialA_{i,t} + \gamma_i Controls_{i,t} + YEAR + INDUSTRY + \varepsilon_{i,t} \quad (3)$$

Here, Model (1) is utilized to examine Hypothesis 1, which assesses the influence of the legal system of the target country on the equity selection of Chinese enterprises in cross-border M&A. Models (2) and (3) are employed to test Hypotheses 2a and 2b, respectively. Specifically, the models explore the moderating effects of legal advisors and financial advisors on the main effects.

4. Result

Table 1 displays the descriptive statistics of the main variables. The average equity acquired in the sample companies' M&A stands at 0.5996, with a variance of 0.3588; the minimum value is 0.05, and the maximum value is 1. This finding suggests that significant differences exist in the equity acquisition strategies employed by Chinese enterprises in cross-border M&A in RCEP member countries. The average value of the legal system of the target country is 0.6774. This indicates that approximately two-thirds of the sample firms prefer countries with common law systems for cross-border M&A. The mean values for hiring legal advisors and financial advisors are 0.3548 and 0.3441, respectively. These findings indicate that more than one-third of Chinese enterprises engage legal and financial advisors when conducting cross-border M&A in RCEP member countries.

Table 1. Descriptive Statistics and Correlation Coefficients

	Variables	Mean	S.D.	Min	Max	1
1	Share	0.6	0.359	0.05	1	1
2	Legal System	0.677	0.47	0	1	-0.08
3	Legal Advisor	0.355	0.481	0	1	0.125
4	Financial Advisor	0.344	0.478	0	1	0.157
5	Market Value Size	23.7	1.908	20.298	30.541	-0.024
6	Enterprise age	8.54	6.651	0.178	27.753	-0.053
7	SOE	0.355	0.481	0	1	-0.025

8	Firm performance	0.057	0.064	-0.031	0.435	-0.105
9	R&D intensity	0.027	0.036	0	0.275	0.084
10	Advertising intensity	0.011	0.025	0	0.171	0
11	Industry Competition Level	0.897	0.085	0.502	0.984	0.200*
	Variables	2	3	4	5	6
2	Legal System	1				
3	Legal Advisor	-0.0171	1			
4	Financial Advisor	0.112	0.362***	1		
5	Market Value Size	0.013	0.360***	0.321***	1	
6	Enterprise age	-0.006	0.081	0.219**	0.158	1
7	SOE	0.175*	0.342***	0.220**	0.487***	0.166
8	Firm performance	0.045	-0.038	-0.148	-0.016	-0.142
9	R&D intensity	-0.134	-0.220**	-0.088	-0.275***	-0.105
10	Advertising intensity	0.164	-0.178*	-0.214**	-0.084	0.047
11	Industry Competition Level	-0.167	-0.331***	-0.013	-0.377***	-0.014
	Variables	7	8	9	10	11
7	SOE	1				
8	Firm performance	-0.034	1			
9	R&D intensity	-0.374***	-0.142	1		
10	Advertising intensity	-0.243**	0.032	0.201*	1	
11	Industry Competition Level	-0.496***	-0.02	0.364***	0.137	1

Note(s): N = 93; * $p < 0.10$, ** $p < 0.05$, and *** $p < 0.01$.

Table 2 presents the models used in the analysis. Model (1) serves as the baseline regression, while Model (2) represents the main effect regression. The models are used to demonstrate the impact of the legal system of the target country on the equity proportion of cross-border M&A by Chinese enterprises. Models (3) and (4) are the moderation effect regressions. They illustrate the moderating effects of hiring legal advisors and financial advisors on the equity acquisition in cross-border M&A by Chinese enterprises in common law countries. In Model (2), the coefficient of the legal system of the target country (Legal System) is -0.270, significant at the 1% level. This finding indicates a significant influence of the legal system of the target country on the equity proportion of cross-border M&A by Chinese enterprises. Specifically, compared to civil law system countries, Chinese enterprises acquire less equity in M&A transactions in common law system countries. Thus, Hypothesis 1 is validated. In Models (3) and (4), the coefficients of the interaction terms between the legal system of the target country and legal advisors, and those of financial advisors, are 1.054 and 0.591, respectively, with both significant at the 1% level. This finding suggests that hiring legal advisors and financial advisors does

indeed weaken the impact of legal system differences on equity selection in enterprises' cross-border M&A. Therefore, Hypotheses 2a and 2b are validated.

Table 2. The Relationship between Legal System and Choice of Equity in Cross-border M&A and the Moderating Effect of Legal Advisers and Financial Advisers

	Model 1	Model 2	Model 3	Model 4	Model 5
Legal		**-0.270*** **	-0.212***	-0.158*	-0.167**
		(-2.91)	(-2.75)	(-1.71)	(-2.08)
LegalA			0.137*		0.105
			(1.72)		(1.27)
Legal ×LegalA			**1.054*** **		0.972***
			(5.72)		(5.09)
FinancialA				0.065	-0.032
				(0.80)	(-0.42)
Legal ×FinancialA				**0.591*** **	0.251
				(3.45)	(1.62)
MarketValue Size	-0.014	-0.046	-0.083**	-0.039	-0.066
	(-0.31)	(-1.03)	(-2.17)	(-0.90)	(-1.66)
Listed age	0.013*	0.005	0.007	0.010	0.011*
	(1.80)	(0.74)	(1.30)	(1.34)	(1.77)
SOE	0.087	0.245*	0.421***	0.153	0.363***
	(0.68)	(1.78)	(3.58)	(1.16)	(3.00)
Firm performance	-0.811	-1.330**	-0.553	-1.541**	-0.633
	(-1.31)	(-2.14)	(-1.03)	(-2.62)	(-1.17)
RD intensity	5.426**	5.557**	11.257***	4.923*	11.607***
	(2.05)	(2.04)	(4.00)	(1.84)	(3.85)
AD intensity	-3.515*	-2.549	-0.975	-2.023	-1.449
	(-1.97)	(-1.46)	(-0.67)	(-1.19)	(-0.96)
HHI_D	0.354	1.229	4.874***	2.001	4.428**
	(0.19)	(0.67)	(2.99)	(1.14)	(2.68)
_cons	-0.152	-0.009	-2.764*	-0.806	-2.706*
	(-0.08)	(-0.01)	(-1.87)	(-0.48)	(-1.85)
INDUSTRY	Yes	Yes	Yes	Yes	Yes
YEAR	Yes	Yes	Yes	Yes	Yes
chi2	153.579	161.833	197.181	174.211	199.987
ll	2.699	6.826	24.500	13.015	25.903
N	93.000	93.000	93.000	93.000	93.000

Note(s): * p < 0.10, ** p < 0.05, and *** p < 0.01. Two-tailed tests; t-values are shown in parentheses

4.1 Endogeneity Analysis

The present study may encounter some endogeneity issues that could affect the accuracy of the results. However, the study subject, namely legal system, possesses certain unique characteristics that mitigate endogeneity problems. Firstly, legal system is a historical choice of national legal systems and ideologies (Kock and Min, 2016), implying that legal system is not randomly generated but determined by a series of historical events. Hence, legal system can be considered to be exogenously given (Kim et al., 2017). Secondly, due to its nature, legal system remains a constant value at the data level and does not change over time, ensuring that the research data are not influenced by temporal factors. Overall, legal system is exogenously given and does not lead to estimation bias due to reverse causality.

4.2 Robustness Tests

In order to ensure the accuracy and reliability of the research conclusions, this paper also conducts the following robustness tests:

4.2.1 Deals with Less than 10% M&A Ratio are Excluded

To ensure robustness, when considering the possibility of joint investments, transactions in which the acquisition equity ratio is less than 5% were adjusted to include transactions in which the acquisition equity ratio is less than 10%. The results of this examination are presented in Table 3. As can be seen, the coefficient for the legal system of the target country (Legal System) remains significant at the 5% level, with a coefficient of -0.263. Thus, Hypothesis H1 is confirmed. The interaction coefficients between the legal system of the target country and legal advisors, and those of financial advisors, are significant at the 1% level, with coefficients of 1.024 and 0.721, respectively. These findings validate Hypotheses 2a and 2b. Overall, robustness has been confirmed.

Table 3. Deals with Less than 10% M&A Ratio are Excluded (Robustness Tests)

	Model 1	Model 2	Model 3	Model 4	Model 5
Legal		**-0.263****	-0.287***	-0.082	-0.222**
		(-2.42)	(-3.28)	(-0.74)	(-2.39)
LegalA			0.255***		0.248**
			(2.88)		(2.71)
Legal×LegalA			**1.024*** **		0.940***
			(5.45)		(4.92)
FinancialA				0.022	-0.103
				(0.25)	(-1.33)
Legal×FinancialA				**0.721*** **	0.255
				(3.96)	(1.60)
_cons	2.029	1.536	-2.356	1.854	-1.870
	(0.93)	(0.72)	(-1.35)	(0.94)	(-1.08)

Control	Yes	Yes	Yes	Yes	Yes
INDUSTRY	Yes	Yes	Yes	Yes	Yes
YEAR	Yes	Yes	Yes	Yes	Yes
chi2	138.602	144.523	182.197	159.724	186.660
ll	1.694	4.654	23.491	12.255	25.723
N	87.000	87.000	87.000	87.000	87.000

Note(s): * p < 0.10, ** p < 0.05, and *** p < 0.01. Two-tailed tests; t-values are shown in parentheses

4.2.2 Alternative Moderating Variable Test

Regression analysis was conducted using the number of legal advisors and financial advisors, rather than whether legal advisors and financial advisors were hired. The resulting findings are presented in Table 4. The results show that the coefficients of the interaction between the legal system of the target country and the number of legal advisors and financial advisors are 0.929 and 0.301, respectively. Both coefficients are significant at the 1% and 5% levels. These results align with the original regression findings, thereby confirming the robustness of the analysis.

Table 4. Alternative Moderating Variable Test (Robustness Tests)

	Model 1	Model 2	Model 3	Model 4	Model 5
Legal		**-0.270*** **	-0.190**	-0.234**	-0.206**
		(-2.91)	(-2.53)	(-2.42)	(-2.56)
LegalA			0.091		0.088
			(1.30)		(1.18)
Legal×LegalA			**0.929*** **		0.923***
			(5.64)		(5.18)
FinancialA				0.162**	0.050
				(2.41)	(0.75)
Legal×FinancialA				**0.301** **	-0.023
				(2.55)	(-0.20)
_cons	-0.152	-0.009	-2.384	-0.263	-2.380
	(-0.08)	(-0.01)	(-1.63)	(-0.16)	(-1.63)
Control	Yes	Yes	Yes	Yes	Yes
INDUSTRY	Yes	Yes	Yes	Yes	Yes
YEAR	Yes	Yes	Yes	Yes	Yes
chi2	153.579	161.833	200.195	174.650	201.046
ll	2.699	6.826	26.007	13.235	26.433
N	93.000	93.000	93.000	93.000	93.000

Note(s): * p < 0.10, ** p < 0.05, and *** p < 0.01. Two-tailed tests; t-values are shown in parentheses

4.2.3 Alternative Independent Variable Test

A viewpoint in academia suggests that legal systems reflect the culture and values of a nation, which in turn have been demonstrated to have close ties with the economy (Beugelsdijk et al., 2018; Dow and Ferencikova, 2010). To ensure the robustness of this study's findings and to dismiss the possibility of cultural distance acting as a substitute for legal systems, cultural distance is now incorporated as an independent variable. Cultural distance (CD) is computed using Hofstede's cultural dimensions, encompassing individualism, power distance, masculinity, and uncertainty avoidance (Hofstede, 1984). As presented in Table 5, the final results indicate that neither the main effects nor the interaction terms between the independent variables and moderator variables are statistically significant. From a statistical standpoint, the explanatory power of cultural proximity is minimal. This finding suggests that culture cannot elucidate the influence of legal systems.

Table 5. Alternative Independent Variable Test (Robustness Tests)

	Model 1	Model 2	Model 3	Model 4	Model 5
CD		**-0.059**	-0.093**	-0.057	-0.095**
		(-1.55)	(-2.39)	(-1.49)	(-2.47)
LegalA			0.282***		0.276***
			-2.86		-2.85
CD×LegalA			-0.073		-0.146*
			(-1.09)		(-1.98)
FinancialA				0.068	0.019
				-0.79	-0.24
CD×FinancialA				0.083	0.156**
				-1.2	-2.21
_cons	-0.152	-0.015	-0.852	-0.332	-0.907
	(-0.08)	(-0.01)	(-0.47)	(-0.18)	(-0.51)
Control	Yes	Yes	Yes	Yes	Yes
INDUSTRY	Yes	Yes	Yes	Yes	Yes
YEAR	Yes	Yes	Yes	Yes	Yes
chi2	153.579	155.948	165.674	158.185	170.489
ll	2.699	3.884	8.747	5.002	11.154
N	93	93	93	93	93

Note(s): * p < 0.10, ** p < 0.05, and *** p < 0.01. Two-tailed tests; t-values are shown in parentheses

5. Discussion

This study examines the relationship between the legal system of target countries and the equity

selection of Chinese enterprises in cross-border mergers and acquisitions (M&A). Also investigated are the moderating effects of whether the acquiring firm engages legal advisors and financial advisors. The following conclusions are drawn: (1) Compared to civil law system target countries, Chinese enterprises tend to acquire a smaller proportion of shares in common law system target countries during cross-border M&A. This suggests that legal system influences firms' internationalization decisions, and specifically, Chinese enterprises tend to acquire a lower proportion of equity in countries with different legal systems. (2) Legal and financial advisors mitigate the impact of legal system on equity selection in cross-border M&A. This finding implies that, by engaging legal and financial advisors, Chinese enterprises can reduce information asymmetry, mitigate outsider disadvantages, and alleviate decision-makers' perceived risks in cross-legal system mergers. Ultimately, this will lead to acquiring more equity in common law system countries.

5.1 Practical Implications

The practical implications of this study manifest in the following three points: Firstly, the research unveils how and why companies are influenced by differences in legal systems when engaging in cross-border M&A. One key result is the phenomenon of acquiring less equity in target countries with different legal systems. Such decisions, i.e., those influenced by legal system disparities, are imprudent. Companies should prioritize understanding the impact of legal system differences. When making decisions regarding cross-border M&A equity selection, the factors that should be considered are whether the financial system is market-oriented, the level of protection for foreign investors and creditors, and the actual risks faced by the company. Examining these issues will allow companies to make more informed choices. Secondly, for companies conducting cross-border M&A in countries with different legal systems, hiring professional legal and financial advisors can effectively mitigate the impact of legal system differences. Taking this step will enable companies to obtain and hold more equity in countries with different legal systems. Thirdly, companies should bolster the levels of their own legal education as they expand globally. Most companies are unaware of the impact of legal systems, and they do not recognize the significance of law in the process of cross-border M&A. This is especially relevant with regard to international commercial law. This lack of awareness frequently leads to confusion and uncertainty. Therefore, companies from emerging economies should recognize the significance of legal system differences, enhance their understanding of legal knowledge, and prioritize international commercial law.

5.2 Limitations and Future Research Directions

This study has a number of limitations, as follows: (1) Although originating from civil law, the systems of civil law itself can be further categorized into various systems, such as the French-system system, the German-system system, the Scandinavian-system system, and the socialist-system system. Moreover, some countries originally operating under civil law are significantly influenced by the common law of the United States. In fact, a more detailed distinction could be made among these civil law-system countries to further explore the impact of legal systems. (2) The samples selected in this

study focus on mergers and acquisitions by Chinese companies in RCEP member countries. As such, the results of the study may not be applicable to developed countries or regions. Future research could expand the scope of sample selection and utilize a global sample, which could be used to further validate the impact of legal systems on corporate cross-border M&A equity decisions.

Fund Project

Graduate Innovation Program funded by School of Economics, Guangxi University/China-Asean Financial Cooperation School.

References

Addi, H. M., & Abubakar, A. B. (2022), Investment and economic growth: do institutions and economic freedom matter? *International Journal of Emerging Markets No. ahead-of-print*. https://doi.org/10.1108/IJOEM-07-2021-1086

Ahammad, M. F., Konwar, Z., Papageorgiadis, N., Wang, C., & Inbar, J. (2018). R&D capabilities, intellectual property strength and choice of equity ownership in cross-border acquisitions: evidence from BRICS acquirers in Europe. *R&D Management*, *48*(2), 177-194. https://doi.org/10.1111/radm.12274

Ahmed, T., Karmaker, C. L., Nasir, S. B., & Moktadir, M. A. (2023). Identifying and analysis of key flexible sustainable supply chain management strategies toward overcoming the post-COVID-19 impacts. *International Journal of Emerging Markets*, *18*(6), 1472-1492. https://doi.org/10.1108/IJOEM-12-2021-1830

Amiram, D., Bozanic, Z., Cox, J. D., Dupont, Q., Karpoff, J. M., & Sloan, R. (2018). Financial reporting fraud and other forms of misconduct: a multidisciplinary review of the literature. *Review of Accounting Studies*, (23), 732-783. https://doi.org/10.1007/s11142-017-9435-x

Baier, S. L., Yotov, Y. V., & Zylkin, T. (2019). On the widely differing effects of free trade agreements: Lessons from twenty years of trade integration. *Journal of International Economics*, (116), 206-226. https://doi.org/10.1016/j.jinteco.2018.11.002

Becchetti, L., Ciciretti, R., & Conzo, P. (2020). Legal Systems and Corporate Social Responsibility. *Sustainability*, *12*(7). https://doi.org/10.3390/su12072717

Beck, T., Demirguc-Kunt, A., & Levine, R. (2004). *Law and firms' access to finance*. National Bureau of Economic Research Cambridge, Mass., USA. https://doi.org/10.3386/w10687

Bergman, N. K., & Nicolaievsky, D. (2007). Investor protection and the Coasian view. *Journal of Financial Economics*, *84*(3), 738-771. https://doi.org/10.1016/j.jfineco.2005.11.003

Berry, H., Guillén, M. F., & Zhou, N. (2010). An institutional approach to cross-national distance. *Journal of international business studies*, (41), 1460-1480. https://doi.org/10.1057/jibs.2010.28

Beugelsdijk, S., Kostova, T., Kunst, V. E., Spadafora, E., & Van Essen, M. (2018). Cultural distance and firm internationalization: A meta-analytical review and theoretical implications. *Journal of*

Management, *44*(1), 89-130. https://doi.org/10.1177/0149206317729027

Bi, X., & Wang, D. (2018). Top-tier financial advisors, expropriation and Chinese mergers & acquisitions. *International Review of Financial Analysis*, (57), 157-166. https://doi.org/10.1016/j.irfa.2018.03.002

Buckley, P. (2019). China goes global: provenance, projection, performance and policy. *International Journal of Emerging Markets*, *14*(1), 6-23. https://doi.org/10.1108/IJoEM-01-2017-0006

Chang, X., Shekhar, C., Tam, L. H., & Yao, J. (2016). The information role of advisors in mergers and acquisitions: Evidence from acquirers hiring targets' ex-advisors. *Journal of Banking & Finance*, (70), 247-264. https://doi.org/10.1016/j.jbankfin.2016.05.006

Chari, M. D., & Chang, K. (2009). Determinants of the share of equity sought in cross-border acquisitions. *Journal of International Business Studies*, (40), 1277-1297. https://doi.org/10.1057/jibs.2008.103

Chen, S.-F. S., & Hennart, J.-F. (2004). A hostage theory of joint ventures: why do Japanese investors choose partial over full acquisitions to enter the United States? *Journal of Business Research*, *57*(10), 1126-1134. https://doi.org/10.1016/S0148-2963(03)00041-9

Chittoor, R., Aulakh, P. S., & Ray, S. (2015). What drives overseas acquisitions by Indian firms? A behavioral risk-taking perspective. *Management International Review*, (55), 255-275. https://doi.org/10.1007/s11575-015-0238-7

Crossland, C., & Hambrick, D. C. (2011). Differences in managerial discretion across countries: how nation-level institutions affect the degree to which ceos matter. *Strategic Management Journal*, *32*(8), 797-819. https://doi.org/10.1002/smj.913

De Vita, G., Li, C., & Luo, Y. (2020). Legal system and financial development: A propensity score matching analysis. *International Journal of Finance & Economics*, *27*(1), 535-553. https://doi.org/10.1002/ijfe.2167

Dow, D., & Ferencikova, S. (2010). More than just national cultural distance: Testing new distance scales on FDI in Slovakia. *International Business Review*, *19*(1), 46-58. https://doi.org/10.1016/j.ibusrev.2009.11.001

Franks, J. R., Mayer, C., & Rossi, S. (2003). *The systemation and evolution of ownership and control*. Available at SSRN 404720.

Glaeser, E. L., & Shleifer, A. (2003). The rise of the regulatory state. *Journal of economic literature*, *41*(2), 401-425. https://doi.org/10.1257/.41.2.401

Graham, M., Walter, T. S., Yawson, A., & Zhang, H. (2017). The value-added role of industry specialist advisors in M&As. *Journal of Banking & Finance*, (81), 81-104. https://doi.org/10.1016/j.jbankfin.2017.04.010

Hofstede, G. (1984). *Culture's consequences: International differences in work-related values*. Sage.

Huang, Q., Zhang, R., Li, S., Li, J., & Yao, Q. (2024). The role of financial advisor's industry expertise in M&A quality: Evidence from goodwill impairment. *International Review of Economics &*

Finance, (89), 216-231. https://doi.org/10.1016/j.iref.2023.09.010

Jandik, T., & Kali, R. (2009). Legal systems, information asymmetry, and firm boundaries: Cross-border choices to diversify through mergers, joint ventures, or strategic alliances. *Journal of International Business Studies*, (40), 578-599. https://doi.org/10.1057/jibs.2008.95

Kim, H., Park, K., & Ryu, D. (2017). Corporate Environmental Responsibility: A Legal Systems Perspective. *Journal of Business Ethics*, *140*(3), 381-402. https://doi.org/10.1007/s10551-015-2641-1

Klerman, D. M., Mahoney, P. G., Spamann, H., & Weinstein, M. I. (2011). Legal system or colonial history? *Journal of Legal Analysis*, *3*(2), 379-409. https://doi.org/10.1093/jla/lar002

Kock, C. J., & Min, B. S. (2016). Legal Systems, Corporate Governance, and Environmental Outcomes. *Journal of Business Ethics*, *138*(3), 507-524. https://doi.org/10.1007/s10551-015-2617-1

Krishnan, C., & Masulis, R. W. (2013). Law firm expertise and merger and acquisition outcomes. *The Journal of Law and Economics*, *56*(1), 189-226. https://doi.org/10.1086/667361

La Porta, R., Lopez-de-Silanes, F., Shleifer, A., & Vishny, R. (2002). Investor protection and corporate valuation. *The journal of finance*, *57*(3), 1147-1170. https://doi.org/10.1111/1540-6261.00457

Lassala, C., Carmona, P., & Momparler, A. (2016). Alternative paths to high performance of independent financial advisors: A fuzzy-set analysis. *Journal of Business Research*, *69*(11), 5305-5309. https://doi.org/10.1016/j.jbusres.2016.04.129

Mahoney, P. G. (2001). The common law and economic growth: Hayek might be right. *The Journal of Legal Studies*, *30*(2), 503-525. https://doi.org/10.1086/322053

Manli, H., Huiru, Z., & Shuo, L. (2017). Merger and Acquisition Experiences and Ownership Decisions of Cross-Border Merger and Acquisition in Chinese Firms. *Chinese Journal of Management*, *14*(8), 1134-1142.

Ming, Z., Wei-hong, C., & Hai-lin, L. (2019). Why Do Chinese Enterprises Completely Acquire Foreign High-Tech Enterprises—A Fuzzy Set Qualitative Comparative Analysis (fsQCA) Based. *China's Industrial Economics*, (04), 117-135.

Paul, J., & Jadhav, P. (2019). Institutional determinants of foreign direct investment inflows: evidence from emerging markets. *International Journal of Emerging Markets*, *15*(2), 245-261. https://doi.org/10.1108/IJOEM-11-2018-0590

Pistor, K., Raiser, M., & Gelfer, S. (2000). Law and finance in transition economies. *Economics of transition*, *8*(2), 325-368. https://doi.org/10.1111/1468-0351.00047

Porta, R.L., Lopez-de-Silanes, F., & Shleifer, A. (2008). The economic consequences of legal systems. *Journal of economic literature*, *46*(2), 285-332. https://doi.org/10.1257/jel.46.2.285

Porta, R.L., Lopez-de-Silanes, F., Shleifer, A., & Vishny, R.W. (1998). Law and finance. *Journal of political economy*, *106*(6), 1113-1155. https://doi.org/10.1086/250042

Song, W., Wei, J. D., & Zhou, L. (2013). The value of “boutique” financial advisors in mergers and acquisitions. *Journal of Corporate Finance*, (20), 94-114.

https://doi.org/10.1016/j.jcorpfin.2012.12.003

Sun, S. L., Peng, M. W., & Tan, W. (2017). Institutional relatedness behind product diversification and international diversification. *Asia Pacific Journal of Management*, (34), 339-366. https://doi.org/10.1007/s10490-016-9498-4

Westbrock, B., Muehlfeld, K., & Weitzel, U. (2019). Selecting legal advisors in M&As: Organizational learning and the role of multiplicity of mental models. *Journal of Management, 45*(5), 2193-2224. https://doi.org/10.1177/0149206317753292

Yeoh, S.-B., & Hooy, C.-W. (2022). CEO Age and Cash Holdings around the World: The Moderating Role of Legal System. *Корпоративные финансы*, *16*(4), 46-60. https://doi.org/10.17323/j.jcfr.2073-0438.16.4.2022.46-60

Yupeng, S., Xingqiang, H., Quanlin, G., & Guang, Z. (2011). Legal Systems and the Entry Mode of Foreign Investments: Evidence from China. *Economic Research Journal*, (12), 59-71.