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Santa Barbara

The Political Economy of Cross-Border Corporate Mergers and Acquisitions

A Thesis submitted in partial satisfaction of the requirements for the degree of Master of Arts in Political Science

By

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June 2016

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June 2016

The Political Economy of Cross-Border Corporate Mergers and Acquisitions

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Joon Gu Koh

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An audacious dream of switching career to the academia in the international political economy (IPE) from the financial world is entering a period of suspension with no promise of resumption. Except a ruthful ending my residence in the American Riviera was full of joy and sweet memories. I further deepened my unwavering affection for the inquiries into the world of IPE. I also widened the pool of IPE issues in which I am interested while living in California's Central Coast.

But above all, my life took a big turn and unfolded a completely new chapter in Santa Barbara. I crossed the country to become a PhD student in IPE as a bachelor with background in international finance. Today, I am leaving UCSB to embark on a journey to a brighter future with my family: Yeowon Kil (길예원) – my wife who is my present – and Katherine Heunji Koh (고흔지) – my daughter who is my future. These two people are what sustained and supported my dream to be continued at every turn of vicissitude. My parents – Minwhan Koh (고민환) and Heuijung Lee (이혜정) – have given me an unwavering support as they always have been. My sister – Joonyoung Koh (고준영) was in no way less supportive than others.

For all this, I truly and deeply thank my family for allowing me to be who I am today and to become who I want myself to be. Thank you mom and dad, and

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ABSTRACT

The Political Economy of Cross-Border Corporate Mergers and Acquisitions

By

Joon Gu Koh

Mergers and acquisitions (M&As) among corporations are truly stark phenomena in today's international economy: companies from one country acquire or merge with a company of another country. But today's global economy reveals a lopsided distribution of M&As, i.e. some countries are much more successful in attracting cross-border M&As thereby achieving a better outcome in the development of cross-border corporate M&A market, while others are less successful or unsuccessful. This study questions what leads to successful development of cross-border M&A markets. The study applies a mixed method of statistical analysis and comparative case studies. The statistical analysis, which used a panel data of 167 countries between 2002 and 2012, results in emphasizing the role of the degree of democracy in the development of cross-border corporate M&A markets. The case studies look into Korea and Japan to examine what the 'real-world' examples say about the outcome of statistical analysis. The qualitative study corroborates the statistical findings.

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Part One. Introduction

Marriage is often considered to be among the most crucial events for people's lives, because a "good" marriage can create synergy for the lives of both the bride and the bridegroom. Likewise, a "bad" marriage can shove the couple into a whirlpool of despair which often concludes with divorce. Same idea holds in the corporate world: a good marriage between two companies can lead to a bigger success, i.e. a "win-win" for both companies. But it can also lead to a nightmare – a breakdown. For both cases, what determines the success of marriage or M&A is not difficult to understand. It is nevertheless yet unclear as to what exactly are the determinants of M&A, i.e. what contributes to the establishment of the M&A market, or expanding the volume of M&A activities, yet remains an unanswered question.

It is in this vein which this paper embarks from: this study endeavors to explore the political economy of the development of cross-border corporate mergers and acquisitions (M&As) market. Specifically, the study attempts to understand what political factors contributes to a successful, or less unsuccessful, development of cross-border M&A markets.[1] This is my central research question. The topic intrigues the scholars of the international political economy (IPE) in various dimensions. Among many, the one that makes this topic intellectually intriguing is the depth of exploration. That is, the literature

[1] See p. 5 for the definition of cross-border M&A markets. Also, this study defines the "success" of the development of cross-border M&A markets as the increase of investment inflows in cross-border M&As.

has investigated widely and deeply on financial development and cross-border corporate M&As, and their various aspects. Conversely, the literature has thus far not yet covered the topic of this study in commensurate depth and breadth, thus encouraging further exploitation.

Notwithstanding, the literature reveals propensities toward certain topics, a status in which the topic of this research is left underexploited: first, the economics literature offers a massive volume of studies on the development of financial system. For example, thanks to the pioneering contribution by McKinnon (1973) and Shaw (1973), the economics literature has paved its road to the inquiries on the relationship between the financial development and economic growth, i.e. whether financial development contributes to growth, and if so how. Second, the business administration literature offers a great depth and breadth in the studies of cross-border M&A, and explores the effects of institutions also in great depth and breadth. But an issue with the literature is that it ignores the importance of clarifying what it exactly means by “institution”, i.e. the literature largely takes the concept of institution for granted without attempts to clarify the definition.

Despite such propensities, the comparative political economy literature offers a well-established volume of scholarly works that reveals some clues which help explore the topic of this research – namely the ‘Varieties of Capitalism’ (VoC). The VoC literature is mainly interested in competitiveness at different levels, e.g. firm, industry, and the national economy. And the

literature puts the firm at the center of inquiry and posits a relational view, i.e. the VoC posits that "a firm encounters many coordination problems because its capabilities are ultimately relational" (Hall and Soskice, 2001). The VoC, based on this and other assumptions [2], yields a dichotomy in capitalist economies that is widely applied in ensuing works. In spite of its wide application in studying the capitalist economies its central limitation would be the scope: the VoC literature is concerned primarily with the developed economies, U.S., U.K, France, Germany, etc. This constrains scholarly efforts to apply the dichotomous concepts to wider pool of economies, e.g. underdeveloped and developing countries.

With regard to research method, this study adopts a mixed approach that consists of quantitative and qualitative analyses, and is organized as follows: next section defines the key terms, followed by a literature review so as to generate hypotheses, all of which will be presented in the following section. The study then tests the hypotheses in statistical analysis. The following section presents comparative case studies on a pair of East Asian economies – the Republic of Korea and Japan - to investigate what the real-world case examples say about what the quantitative analysis has yied. The study then discusses the outcome and concludes.

[2] Hall and Soskice (2001) emphasize the role of institutions in capitalist economies as the provider of "capacities for the exchange of information, monitoring, and the sanctioning of defections relevant to cooperative behavior among firms and other actors" (p. 10).

1.2. Key Terms

Merger and Acquisition (M&A) refers to the consolidation of companies. A merger is “a combination of two companies to form a new company", while an acquisition is "the purchase of one company by another in which no new company is formed."[3] In this regard, the cross-border corporate M&As refer to the cases in which a company, or an investor, located in one country takes over or merges with a company in another country.[4] M&As take place for various reasons: companies acquire other companies to expand their business portfolio, obtain certain expertise or technologies as well as patents, or to make inroads into foreign markets. Sometimes the key motivation of corporate M&As is truly financial, i.e. companies acquire other companies to make profit. In this sense, the financial world often discern the acquirers in two categories – the strategic investors (SIs) and the financial investors (FIs). The motivation behind the seller’s side is largely twofold – as part of routine business strategy or as part of their survival attempts. The former pertains to the cases in which companies try to restructure their business portfolio so as to improve the overall efficiency of their business. The latter to the cases in which companies try to get rid of

[3] Quotes are cited from http://www.investopedia.com/terms/m/mergersandacquisitions.asp (accessed 11:53am on Saturday, April 25, 2015)

[4] Whether or not a M&A transaction is a "cross-border" one is determined by the location of the two parties involved, i.e. the acquirer and the target firm. That is, the examples of cross-border M&As can range from a case in which Citigroup taking over the entire stake of Seoul’s KorAm Bank in 2004, to a case in which an American corporation headquartered in New York City acquiring the controlling share of a subsidiary of U.S.-based multinational corporation located in Shanghai, China.

the "troublemakers", i.e. a subsidiary or a business unit that yields poor profitability.

Financial Market refers to a venue wherein buyers and sellers come together to conduct trades in assets and financial products, e.g. stocks, bonds, currencies, and derivatives. Financial markets are "typically defined by having transparent pricing, basic regulations on trading, costs and fees and market forces determining the prices of securities that trade."[5] Examples of financial markets include the New York Stock Exchange (NYSE), Chicago Mercantile Exchange, and Seoul's foreign exchange (forex or FX) market. Likewise, **M&A market** refers to a market place wherein the purchase and the sale of a controlling share of companies, or subsidiaries, are conducted. Particularly, cross-border M&A market refers to an arena wherein the investor(s) from one country acquires or merges a company from another country.

Economic Openness, often called current account openness, refers to the degree to which market economy operates free from various restrictions on international trade. The concept is often measured in terms of the level of trade barriers or the proportion of exports and imports in a country's gross domestic product (GDP). In essence, the degree of economic openness is determined by the level of regulation imposed by the government. In turn, the level of

[5] http://www.investopedia.com/terms/f/financial-market.asp (Accessed 2:14pm PST, Tuesday May 18, 2016)

economic openness determines how much room governments can have in its choice of economic policies they pursue.

Financial Openness refers to the degree to which capital can freely move in and out of a country's financial markets. Thus, the major policy tools for governments to regulate their financial markets are the tax and legal framework: governments often make it tough for the multinational investors to repatriate their profits by levying a repatriation tax, which is often levied in addition to the capital gains tax. Also, governments often demand certain qualifications to be eligible to invest in their home markets, for instance, capital adequacy ratio, business portfolio, past history on foreign investment, the firm type (e.g. deposit-taking institution, non-banking financial institutions, private equity firm, hedge fund, or sovereign wealth fund), etc.

Foreign Direct Investment (FDI) refers to one class of investment made in one country by a company or other entities based in another country. FDIs are made in many different forms – from establishment of a local branch or subsidiary directly by the foreign entity to joint venture and M&As – and are in contrast with portfolio investment. That is, while foreign portfolio investment is carried out by purchasing a debt or acquiring a portion of shares of companies listed in overseas stock markets, FDIs are made when the investor does one of the following: set up a subsidiary in the host country, acquire sufficient shares to exercise a degree of control (usually ten percent or more of voting shares or ordinary shares) of a company, launch a joint venture,

or do M&As. Examples of FDI would include General Motors's joint venture in China, namely Shanghai GM, and Standard Chartered Group's acquisition of Korea First Bank in Seoul to launch Standard Chartered Bank, Korea in 2005.[6]

Financial Liberalization, at its simplest, refers to the opening of a country's financial markets. Financial liberalization opens the door to not only multinational investments, but also various financial technologies, financial products, and business practices of financial institutions, all of which can lead to financial innovation, i.e. the occasions in which financial institutions create new forms of financial instruments and techniques that had not been previously used. Financial liberalization is associated with financial deregulation, in that the latter refers to the alleviation of the restriction on, for example, interest rates and credit allocation.

Financial Institutions (FIs) are the establishments that deal with financial transactions, e.g. deposit and loan, investment, securities trading, trust, underwriting, and trade finance. FIs can be categorized in two types depending on the eligibility to accept deposits – deposit-taking institutions and non-banking financial institutions (NBFIs). The examples of the former category are commercial banks, mutual savings banks, and credit unions. The latter

[6] Standard Chartered Group is a London, U.K.-based international banking institution operating mostly in Southeast Asia, Middle East, and Sub-Saharan Africa. The British bank acquired the entire share of Korea First Bank, in 2005, from New Bridge Capital - a San Francisco, California-based private equity fund (PEF). New Bridge was established in 1994 as a joint venture by three PEFs - Texas Pacific Group, Blum Capital, and ACON Investment - to focus on leveraged buyouts in emerging markets.

would include securities firm, insurance companies, private equity fund, and sovereign wealth funds (SWFs).

Hedge Funds are "alternative investments using pooled funds that may use a number of different strategies in order to earn active return on investment (ROI), or alpha[7], for their investors."[8] Hedge funds may be "aggressively managed or make use of derivatives and leverage in both domestic and international markets with the goal of generating high returns (either in an absolute sense or over a specified market benchmark)."[9] In M&A market, hedge funds usually acquire majority shares to control the firm, i.e. thirty percent or more, thereby enabling them to turn around the acquired firm in ways which makes the sales of those acquired firms more marketable.

Private Equity Funds (PEFs) are similar to hedge funds. But what separates the former from the latter is the source of funds: while hedge funds collect funds from various sources, PEFs raise funds from equity capital, i.e.

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[7] "Alpha" is an indicator measuring the "active ROI", i.e. the performance of a particular investment compared to a relevant market index, e.g. Dow Jones Industrial Average (DJIA) or S&P500. In this sense, an alpha of 1.0 means that the investment, of which alpha is measuring, has outperformed its benchmark index by a percent over a particular period of time. Likewise, an alpha of -1.0 means that that investment has underperformed its benchmark index by one percent during a certain period of time. Another index that the investors pays a great deal of attention to, along with alpha, is "Beta". Simply put, beta tells the investors about the tendency of a security's returns to respond to the ups and downs in the market, and is an index measuring the volatility of particular investment also in comparison with a benchmark, e.g. S&P500, like alpha. Beta equals the monthly returns over the specified comparison period. So if the beta of a stock listed at the New York Stock Exchange (NYSE) is 1.5, then theoretically it means that the stock is fifty percent more volatile than the market - NYSE.

[8] http://www.investopedia.com/terms/h/hedgefund.asp (accessed on 4:50pm, Thursday, March 24, 2016)

[9] http://www.investopedia.com/terms/h/hedgefund.asp (accessed on 4:50pm, Thursday, March, 24, 2016)

capital not quoted on a public exchange. In this regard, the majority of the investors in PEFs consists of various institutional investors, investment banks, SWFs, pension funds, and asset management firms, all of whom can provide a large sum of money for a relatively long period of time. On this note, the PEFs often make a long-term investments to generate profit from turnaround and re-sale or initial public offering (IPO), i.e. acquire a distressed company and turnaround over a number of years so as to be able to sell the company to other investors (often publicly listed ones) or to mass public through IPO.

Investment Bank (IB) is a financial institution that provides various services in a specialized area. IBs usually specialize in complex financial transaction that are financial technology-intensive, e.g. underwriting, asset securitization, advising and managing M&A deals, managing IPOs, and intermediating stock-issuing companies and individual investors.

Leveraged Buyout (LBO) is, put simply, the acquisition of a company with a loan. In other words, LBO refers to the transactions in which an entity buys a company by using a considerable amount of borrowed money to cover the cost of the transaction. In many cases of LBO, the assets owned by the target company is provided as collateral along with the acquirer's assets. The central purpose of conducting LBO is allowing the companies to acquire other companies without having to commit a large sum of capital. While favored by the acquiring company for its convenience, the LBO is often criticized for moral

reasons. That is, the LBO often entails the possibility to leave the acquired company with an empty shell as its assets can be collateralized.

Stock and Flows are among the ways to measure the cross-border M&As. First of all, the stocks of cross-border M&A measure the aggregate level of cross-border M&A "at a given point in time, usually the end of a quarter or of a year." On the contrary, financial flows "consist of equity transactions, reinvestment of earnings, and intercompany debt transactions." Cross-border M&A flows, accordingly, record the value of international transactions "related to direct investment during a given period time, usually a quarter or a year", according the OECD.[10]

[10] https://data.oecd.org/fdi/fdi-stocks.htm (Accessed 2:18pm PST, Tuesday, May 18, 2016)

Part Two. Literature Review

The central question this study aims to answer concerns the political economic determinants of success of the development of cross-border M&A market. That is, the key question addresses what contributes to the development of the market for international corporate M&As. In so doing, this study looks at different sets of relevant literature to the topic of this study. The central goal of this literature review is to derive testable hypotheses.

The literature in economics and political science keep its focus rather broad, i.e. on the development of the financial system as a whole, and explore the relationship between financial development and various economic and political factors. Management studies, on the other hand, focus on the firm- or market / industry-level studies of cross-border M&As, e.g. factors affecting cross-border corporate acquisitions, cross-border bank M&As and risk, cross-border M&As as instruments of comparative advantage, and role of investment banking in developing countries.

In this light, each set of literature serves a unique function for this study. Specifically, the financial development literature, which pertains to economics, provides the theoretical background which sets the theoretical parameters, though largely, of this study. In particular, the literature offers a cornerstone for our theoretical understanding of the dependent variable - the development of corporate M&A sector. Put together, the financial development literature

would serve this study as one of central theoretical platform, if not the central theorical platform.

Second, the M&A literature, which pertains to business studies and specifically the finance realm of the discipline, also has to do with the dependent variable. In detail, the literature not only offers affluent knowledge for understanding M&A, but at least equally importantly, the literature will reveal that it has been overlooking the political aspects of cross-border M&As, a factor which adds to the importance of the topic of this research, as well as to justifying why this research topic is interesting. In sum, each literature has its own focus, but none of the literature alone suffices to help us understand the topic of this proposed project. That is, one can hope to create the foundation for this study only when we bring both literatures together with the comparative political economy literature.

Lastly, the Varieties of Capitalism (VoC) literature serves as the foundation of possible independent variables, particularly the explanatory variables of political domain. As discussed later and as Hall and Soskice (2001) stipulated, the literature strongly implies that each type of different capitalist economies has its own institutional features, and those unique features produce distinctive consequences that are not observed in other types of capitalist economy. On this note, Hall and Soskice (2001) define markets as the "institutions that support relationships of particular types, marked by arm's length relations and high levels of competition", and add that "[a]ll

capitalist economies also contain the hierarchies that firms construct to resolve the problems that cannot be addressed by markets" (p. 9). Also, a brief review of political institution literature will be added to supplement the delineation of basic concepts and themes. The literature is reviewed mainly to make up for the deficiency in the management literature's efforts to clarify what exactly is meant by the term "institution."

2.1. Financial Development

At its simplest, financial development is the development of financial markets in a national economy. This topic has been intensively explored by the economics discipline, and the literature reveals that economists are most interested in, among many plausible research topics, the relationship between financial development and economic growth and the political economy of financial development. That is, it seems reasonable to conclude that the financial development literature has been devoting its attention heavily to the two aforementioned topics, and thus has relatively overlooked other research topics including the one this research strives to explore.

The root of the financial development literature dates back to 1934: a theoretical work by Joseph Schumpeter - *The Theory of Economic Development* - has provided the underlying foundation for the vast majority of the financial development literature that followed, mainly because this book provided the most basic conceptual framework. For example, Schumpeter defined capital as "the sum of means of payment which is available at any moment for

transference to entrepreneurs", and suggested that capital works as the "lever by which the entrepreneur subjects to his control the concrete goods which he needs, a means of diverting the factors of production to new uses, or of dictating a new direction to production" (p. 116). Equally important, Schumpeter asserted that "credit is essentially the creation of purchasing power for the purpose of transferring it to the entrepreneur, but not simply the transfer of existing purchasing power" (p. 107). So the creation of purchasing power "characterizes, in principle, the method by which development is carried out in a system with private property and division of labor" (p. 107).

An immense volume of studies of financial development was conducted in the following decades, and in recent years several works have gained importance. A foundational framework is found in a 1997 study by Ross Levine. In this seminal article, Levine attempts to summarize the literature on financial development and growth. Among his central findings is that the preponderance of theoretical reasoning and empirical evidence suggests a positive effect of financial development on growth. In this article, Levine offers a functional approach to understanding the operation of the financial system. According to Levine, the financial system has five key roles: first, facilitation of trading, hedging, diversifying, and risk-pooling; second, resource allocation; third, monitoring the management of corporations and controlling corporations; fourth, savings mobilization; and fifth, facilitation of the exchange of goods and services. These key roles form the parameters within the scholarly debates on

financial development, according to Levine. On this note, Levine suggests that two research questions to come to be borne at the center of scholarly attention: first, the links between the functioning of the financial system and economic growth, capital accumulation, and technological change, and second, the ties between financial structure (i.e. the mix of financial markets and intermediaries) and the functioning of the financial system.

Another seminal work in the studies of financial development had been published by the two economists then at the University of Chicago - Raghuram Rajan and Luigi Zingales. Rajan and Zingales (2003a) proposed a theoretical framework which introduces a political economy approach to the development of financial markets - namely an "interest group theory of financial development." The key proposition of the theory is that the incumbents of the financial system oppose financial development because it breeds competition. The theory predicts that incumbents' opposition will be weaker when an economy allows both cross-border trade and capital flows. In this vein, Rajan and Zingales explain that, first, the incumbents not only enjoy some rents in the markets they operate but they also end up appropriating most of the returns from new ventures, second, that these rents will be impaired by financial development, because better disclosure rules and enforcement in a developed financial market will reduce the relative importance of incumbents' collateral and reputation, while permitting newcomers to enter and compete away profits.

The explanation continues: third, the key to the ability to lend is the relationships with those who have influence over the firm and the ability to monopolize the provision of finance to a client. The authors thus conclude that a more efficient financial system facilitates entry into the sector, thus leads to lower profits for incumbent firms and financial institutions, and this would imply that, collectively the incumbents have a vested interest in preventing financial development. Here, what is critical is that financial development facilitates the entrance of new firms, thus increasing competition among the incumbents and the new entrants. Finally, Rajan and Zingales emphasize the necessity of government intervention in financial markets, as several components of financial system become essential when countries embark on financial development. Those essentials are, first, respect for property rights, second, an accounting and disclosure system that promotes transparency, third, a legal system that enforces arm's length contracts cheaply, and fourth, a regulatory infrastructure that protects consumers, promotes competition, and controls egregious risk-taking.

As noted earlier, the economics literature has intensively explored the political economy of financial development. Though the majority of studies are empirical, they offer some valuable leeway to predict the possible answers to the research question of this study. Girma and Shortland (2008) studied the effects of a country's democracy characteristics and regime change on financial development. Using panel data from both developed and developing economies

between 1975 and 2000, they found that democratic transition and stable democracy have positive effects on subsequent financial development. Braun and Raddatz (2008) attempted to explore why some countries achieved more financial development than others, and their empirical test yielded a notable outcome - that the promotion of trade liberalization supports financial development.

One of the most salient topics in this strand of literature is the relationship between financial development and economic growth. Numerous scholars have delved into this topic, and so far hold that financial development certainly does contribute to growth. Specifically, studies have shown that several aspects of financial development provide positive effect on economic growth, particularly on total factor productivity growth and rates of factor accumulation (Benhabib and Spiegel, 2000; Gregorio and Guidotti, 1993). Despite their acknowledgement of the positive effect of financial development on economic growth, Gregorio and Guidotti (1993) emphasize the role of proper management (or regulation) of the financial system. They claim that, based on the Latin American experience of 1970s and 80s, cases can be made that "unregulated financial liberalization and expectations of government bailouts can lead to a negative relationship between the degree of financial intermediation and growth." Gregorio and Guidotti added that the central medium through which financial development leads to growth is the effect on the efficiency of investment, not its level.

On a similar note, Shen and Lee (2006) delved into the causal relationship between financial development and economic growth. From their empirical studies of forty-eight countries between 1976 and 2001, they found that only stock market development has a positive effect on the growth of real GDP per capita. Also, the study discovered that the conditional variables, e.g. financial liberalization, high-income level, and good shareholder protection mitigate the negative impact of banking development on growth, as well as that the progress in stock market development facilitated economic growth in many parts of the developing world, Latin America, Sub-Saharan Africa, and East Asia.

This review of financial development literature suggests what the literature can offer for this study: the literature provides a ground that sets the parameters of the theoretical origin of this research. But more importantly, the literature offers a theoretical foundation for the dependent variable - the development of cross-border M&A sector. This is because the debates and studies in this particular literature looks into the financial system as a whole, a unit which subsumes the corporate M&A sector. This, in turn, enables this study to apply findings to the financial development theories to understand the development of a domain of a more specific category – the cross-border corporate M&A sector.

2.2. Cross-Border M&As

The management studies literature provides an enormous volume of scholarly works on cross-border corporate mergers and acquisitions. Research topics explored in the literature seem much diffused. In short, the literature reveals an enormously wide array of issues, for example, some studies examine the international and regional perspectives of cross-border corporate M&As, and some studies look at various types of M&A markets. Also, some theoretical studies have looked at where the gains from M&As come from, and at why corporations pursue M&As. So this study walks through some of the very basic but relevant pieces which cover the theoretical foundation of this research project.

One of the most extensively exploited topics in the M&A literature delves into the key driving force of cross-border M&As. A study by Di Giovanni (2005) looked at the key roles of macroeconomic and financial variables in the multinational corporation's (MNC) decision for cross-border M&As. His empirical study, using a panel data of cross-border M&As between 1990 and 1999, revealed that financial variables and institutional factors play a considerable role in cross-border M&A. More specifically Di Giovanni discovered that the size of financial markets yields a strong positive effect on a firm's decision to do M&A abroad, e.g. "a 1% increase of the stock market to GDP ratio is associated with a 0.955% increase in cross-border M&A activity" (p. 145).

With regard to the key driving forces of cross-border M&As, Jongwanich et al. (2013) suggest five motives behind cross-border M&As. First, a search for strategic natural resources: some corporations, mostly manufacturers, are consistently distressed by the amount of national resources at hand. For these companies the prime motive is to secure sufficient amount of natural resources so as to enhance the stability of input for their production. Second is market access opportunity or expansion. Dramatic increase in the presence of MNCs in China is a clear example: as China put an end to its long hibernation when Deng Xiaoping launched "Reform and Open-Door" economic policies in 1978, MNCs flooded into China for export market. And this influx of the FDI widened the horizon of foreign capital's business in China to targeting a domestic market of 1.3 billion people.

Third, Jongwanich et al. (2013) suggest that MNCs aim at the enhancement of efficiency of their operation through cross-border M&As. This is particularly true when we look at the cases in which MNCs from developed economies, e.g. U.K. and U.S., or western Europe, acquire or establish companies in underdeveloped countries where factors of production, especially labor, are cheap and abundant. Fourth, MNCs do cross-border M&As to grasp the opportunity to acquire assets, so that they can maintain their competitive position in the markets where they operate. Fifth and lastly, Jongwanich et al. claim that a "financially deep market provides firms access to the capital necessary to undertake cross-border investment." Thus, they continue that

"financial deepening, both in terms of size and liquidity, within a country is crucial in aiding its firms to raise in their home country for investment abroad" (p. 268).

2.3. Varieties of Capitalism

One other literature relevant to this topic lies in the comparative political economy (CPE), which provides an insightful set of knowledge and theory through the so-called "Varieties of Capitalism" (VoC) literature. Emerged in late 1990s, the VoC literature has been triggering much academic interests in the political economy field, largely owing to a seminal work by Soskice and Hall (2001). In this book, the two authors offer a new framework for understanding the institutional features of different types of capitalist economies – the two main types are what Hall and Soskice call liberal market economies (LMEs) and coordinated market economies (CMEs).

LME is a type of capitalist economies in which all necessary coordination for firms is done through the basic market mechanism. Hall and Soskice (2001) explain that in LMEs "firms rely more heavily on market relations to resolve the coordination problems[11] that firms in CMEs address more often via forms of non-market coordination that entail collaboration and strategic interaction"

[11] Hall and Soskice (2001) assume that firms are relational entities. That is, they see firms as "actors seeking to develop and exploit core competencies or dynamic capabilities understood as capacities for developing, producing, and distributing goods and services profitably" (p. 6). In this light, the two scholars posit that forms face a wide range of coordination problems because the capabilities of a firm is relational, thus that the success of a firm "depends substantially on its ability to coordinate effectively with a wide range of actors" (p. 6).

(p. 27). Thus the degree of institutional support for non-market forms of coordination is lower in LMEs than in CMEs. In LMEs, market relationships are characterized by "the arm's-length exchange of goods or services in a context of competition and formal contracting" (p. 8). The United States is a major example of this category.

CMEs, on the other hand, rely more on "non-market relationships to coordinate their endeavors with other actors and to construct their core competencies." So these mode of "non-market coordination generally entail more extensive relational or incomplete contracting, network monitoring based on the exchange of private information inside networks, and more reliance on collaborative, as opposed to competitive, relationships to build the competencies of the firm" according to the two scholars (2001, p. 8). Germany is a prime example. What is perhaps most striking about Hall and Soskice's work is that it creatively departs from the state-centric view and puts the firm at the heart of their research. That is, the two authors take the firm, not the state, as the basic unit of analysis and posit firms to be a "relational" entity in the national economy so that they can take a deeper look at how different capitalist market economies are operated at a "hands-on" level. Hall and Soskice argue that "because its capabilities are ultimately relational, a firm encounters many coordination problems" (p. 6).

Their work is also accredited for its ambition to embrace a multi-disciplinary approach to studying market economies, as noted clearly in the

authors' comment: they assert that they "hope to build bridges between business studies and comparative political economy, two disciplines that are all too often disconnected" (p. 5), and also that "[b]y integrating game-theoretical perspectives on the firm of the sort that are now central to microeconomics into an analysis of the macro-economy, we attempt to connect the new microeconomics to important issues in macroeconomics" (p. 5).

Hall and Soskice's work focuses on examining capitalist economies in terms of five different criteria: first, industrial relations and wages and productivity, i.e. how wages are determined, second, vocational training and education, third, corporate governance, particularly returns of investment, fourth, inter-firm relations, i.e. do firms compete with other companies in their industry or do they rather collaborate?, and fifth, relations with employees, i.e. what is the relationship between the management and the employees of a firm, is it adversarial or cooperative? LMEs largely resort to the basic free-market mechanism in solving the aforementioned issues while CMEs approach the issues more strategically. In other words, LMEs are prone to tackle the issues in a so-called *laissez-faire* manner, leaving the issues to the "invisible hand", whereas the CMEs approach by trying to coordinate different interests of various parties involved.

Numerous academic efforts have been made following Hall and Soskice (2001) to further scholarly understanding of capitalist market economies, and among them is an attempt to study how market economies change over time

as institution. Hall and Thelen (2009) have attempted to develop an approach to institutional change that is extended from the one provided in Hall and Soskice (2001). Several propositions of Hall and Thelen are worth noting: first, institutional stability as a political problem; and second, institutional change in the political economy.

To begin, Hall and Thelen (2009) argue that institutional stability is a political issue. They believe that the employer's interests should be at the center of analysis, and this underscores a critical assumption - namely that the institutions and practices of capitalist political economies can rarely be sustained over time without the active support of at least some powerful segments of capital. In addition, the authors note that the VoC framework holds that, in a more active process in which entrepreneurial actors seek to advance their interests, including in contexts of strategic interaction, institutions can improve the well-being of those who participate in them by resolving collective action dilemmas. This leads the authors to claim that institutional stability of capitalist market economies is surrounded by politics, and that attaining coordination amongst various related-entities is a political problem since the two types in the original VoC literature - LMEs and CMEs - are categorized based on how inter-firm coordination is implemented.

Another thing to note in Hall and Thelen's work relates to institutional change in the political economy of market economies. The assumption here is that the existing institutions are bound to come under pressure because

market economies are full of entrepreneurial actors interested in improving their positions, and the issue would be what precipitates change, which actors are central to it, how will it occur, and how should we interpret the results? That said, Hall and Thelen believe that the impetus for institutional change, at least in the cases of advanced European economies, had been "unanticipated" effects flowing from existing institutions, i.e. the institutional change was not entirely a series of responses to external shocks.

On this note, the authors approach institutional change in capitalist market economies as the politics of coordination, i.e. inheriting and furthering the stance Hall and Soskice took. For Hall and Thelen, specific types of coordination (whether market or strategic) can be sustained throughout many changes in the formal institutional infrastructure governing a political economy, and one of the routes to institutional change that is often under-investigated is “reinterpretation.” That is, the actors associated with an institution gradually change their interpretation of its rules, and thus its practices, without defecting from or dismantling the formal institution itself.

In sum, Hall and Thelen argue that, first, even when institutions are Pareto-improving in the context of strategic interaction, their stability should not be taken for granted because it rests on a highly political process of mobilization marked by conflict and experimentation through which informational issues are resolved and distributional issues contested. Second, they claim that an institutional "ecology" in which the strategies of the actors

are simultaneously conditioned by multiple institutions, and the process of institutional change is one of mutual adjustment, inflected by distributive concerns, with incremental impacts on the strategies of firms and other actors.

Also building up from Hall and Soskice, Kathleen Thelen (2009) studied how institutional changes are made in LMEs and CMEs, i.e. how the process of institutional change has been made in the two categories and what was the result. Her central claim is that key political-economic institutions are constructed in the context of some historical choice point in the past, and then once they are in place, they lay out an enduring logic of political development. Thelen adds that several cases suggest that significant institutional change often takes place gradually and through a cumulation of seemingly small adjustments even in “settled times”, or at least in the absence of some obvious historical rupture.

Thelen's contribution to the VoC literature, I argue, emerges from her attempts to diversify CMEs: she categorizes CMEs in terms vocational education and training. In detail, she endeavors to categorize CMEs based on how firms in CMEs coordinate vocational training: on the one end of Thelen's horizon is "solidarist", the firms that have relatively encompassing scope and uniform contents in their vocational education and training (e.g. Sweden), and on the other is "segmentalist", where training is concentrated in large firms and the skills acquired are company specific, i.e. not organized around national occupational labor markets, but instead around internal labor markets within

firms (e.g. Japan). Thelen explains that the important conceptual point would be that "such developments do not 'register' as change on the VoC dimension, since they do not represent a breakdown of coordination so much as they do a reconfiguration of coordination on less solidaristic terms" (p. 481).

Empirical efforts have been made to test the aforementioned theoretical works in the VoC realm. Hall and Gingerich (2009) tried to test the institutional complementarities postulated in the VoC literature, with particular focus on labor relations and corporate governance. By the way, Hall and Soskice (2001) argue that institutional complementarities suggest that "nations with a particular type of coordination in one sphere of economy should tend to develop complementary practices in other spheres as well" (p. 18). Hall and Gingerich launched about a dozen of hypotheses regarding the VoC literature, and garnered by and large support. For instance, the VoC literature's attempts to establish coordination as a critical aspect as well as the congruence across the spheres of political economy were both supported.

Although it seems quite clear that the VoC literature has been burgeoning since its emergence at the turn of the millennium, the literature has not evolved without criticism. Among many, a set of critiques laid out by Mark Blyth (2003) garners much scholarly attention. In a nutshell, Blyth's critiques are twofold. First, Blyth points out that Hall and Soskice (2001) fail to maintain impartiality in their analysis. In detail, Blyth claims that Hall and Soskice implicitly argue for the CMEs and thereby for the egalitarian

distributions and outcome typical of European political economies in the face of the neo-liberal onslaught.

More importantly, Blyth questions the authors' understanding of the developed economies they studied. That is, he raises an issue regarding the possibility that the conventional critique of the European economies is wrong. In particular, Blyth questions if Europe's economic performance was indeed as bad as the critics said, and how would the VoC literature have changed if Germany were not classified as a CME. Lastly, Blyth questions a conventional understanding of the U.S. economy - what if the success of the U.S. economy does not come from it being a LME? Despite the fact that Blyth's critiques can be seen as rash to some viewers, it seems reasonable to state that Blyth's critiques should be recognized as legitimate efforts to contribute to the scholarly rigor of the VoC literature.

All in all, it seems quite clear that the VoC literature has made considerable progress over the course of past decade and a half, it has maintained its ground principally on the political science discipline, i.e. the literature has not yet made significant progress in its interdisciplinary approach with other relevant fields, e.g. business administration and economics. This is an important part of the central motivation of this project - the ambition of building solid bridges between the political economy studies of the political science discipline and the finance studies in the business administration discipline.

On this note, the VoC literature offers this study an important foundation for understanding the political dimension of cross-border corporate M&As, as noted earlier. That is, the literature suggests that each type of capitalist economies has its own institutional features and those features yield unique consequences. This, in turn, provides this study with the ground from which some meaningful explanatory variables can be extracted, e.g. how the basic market mechanism is set up and how institutions function within each type of capitalist economies.

2.4. Institutions

Institutions are perhaps one of the most extensively studied topics in several academic disciplines, ranging from political science to economics and sociology. For example, the economics literature is mainly concerned with institutions that constitute markets, while sociology is mainly interested in social institutions that govern the lives of individuals and society. Regardless of the discipline, the academic literature almost ascertains an idea that institutions matter by a great deal for not only economic transactions like cross-border-M&As, but more importantly, to every aspect of our daily lives. In essence, this is primarily because institutions are "the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction" (North, 1990). Accordingly, institutions shape human interaction. When it comes to institution, the international relations (IR) discipline suggests several ways to define. Among them are Douglas North's

aforementioned definition, and one by Koremenos et al. (2001): institutions as "explicit arrangements, negotiated among international actors that prescribe, proscribe, and/or authorize behavior."

That said, this study constrains its conceptual boundary of institutions within the realm of political economy. This section reviews some of the major works that shed lights on the central question – the political factors that affect the development of international corporate M&A markets. On this note, this study limits its focus to institutions in the economic and political arenas. To begin with, all economic systems struggle with a fundamental political dilemma – confiscation. That is, while strong governments are presumably more capable of protecting their citizen's private ownership of wealth than weak governments, their capability also enables them to exert a great level of discretion thereby expropriating their citizen's wealth freely at their will. This fundamental dilemma therefore begs a question of what form of political system is required.

Weingast (1995) answers this question by arguing that the answer lies in the credible commitment of the state to preserve markets. In other words, the political system in countries with thriving markets are well capable of limiting future political discretion with respect to the economy that are in the interests of political officials to observe. He asserts that the key ingredient of "a credible commitment to limited governments is that these limits must be self-enforcing" (p. 2), and that "the political foundations of markets are as

essential to their success as the details and specification of the market itself" (p. 25).

Despite Weingast's logical delineation of the role of political institution in a national economy, it can still be questionable as to the utility of political institution, i.e. what purpose, if any, do political institutions serve. According to Terry Moe (1990), political institutions provide two distinctive functions: mitigating collective action problem and facilitating coercion and redistribution. Moe explains that institutions help solve the issue of commitment and enforcement, both of which are debilitating to political interactions, thereby encouraging cooperation amongst political actors "in the realization of gains from trade" (p. 213). With regard to the facilitation of coercion and redistribution, Moe holds that political institutions serve as a weapon of coercion and redistribution, in that they determine how political winners should pursue their own interests, frequently at the expense of political losers.

These accounts of political institutions are grounded upon a couple of basic assumptions. First, politics as an arena in which exchanges are arranged. Second, politics as creating and sustaining institutions (March and Olsen, 1996). The first assumption reflects a view in which individual preferences are aggregated into collective actions through negotiation, coalition, and exchanges. March and Olsen (1996) explain that, in this view "individual actors have prior desires (preferences, interests) which they use to determine the

attractiveness of expected consequences", and that "[c]ollective action depends on the negotiation of bargains and side-payments among potential trading partners." The second assumption reflects a constructivist view: actors keep their behavior in conformity with socially constructed rules. Here, the key is that "life is organized by sets of shared meanings and practices that come to be taken as given for a long time", and also that it is political institutions that set the rules and terms and conditions of exchange (March and Olsen, 1996).

Another important item that has been arduously explored in the political institution literature is veto players. In a nutshell, existence and influence of the veto players in politics is what produces a critical contrast between democracy and non-democracies. That is, the higher the degree of vetoes in the political arena the more difficult it is for the incumbent political leaders to transform the political status quo to their favor (Tsebelis, 1995). In other words, the more veto players in the political arena, the less regulation the government can enforce, the less centralization of power, and the less the level of state autonomy. Or, borrowing from the concepts of Bueno de Mesquita et al. (2003), the more veto players in politics the larger winning coalition for the incumbent leadership, thus harder to accomplish their policy objectives which could sustain their political survival.

Stepan and Linz (2011) fleshed out the features of the veto players in politics, using an American example. First of all, Stepan and Linz explain that equal vote in the U.S. Senate for every state in the Union "generates by far the

greatest violation of the classic majority principal of “one person, one vote” of any of the eight federal democracies (p. 844). Second, the two scholars explain that the Senate’s upper hand in terms of the “influence on federal appointments than “one person, one vote” House of Representatives, and more prerogatives than any other democratically elected upper house” (p. 846). Third, the “majority-constraining features are constitutionally embedded and could, in theory, be changed by amendments supported by exceptional majorities of citizens” (p. 846).

These basic insights into political institutions lead to a question about the influence of institutions on our day-to-day politics. Bruce Bueno de Mesquita et al. (2002) studied how political institutions influence the incentives of political leaders to distribute resources toward the provision of public goods, e.g. national security and the rule of law, and private goods. Bueno de Mesquita et al.’s empirical study yielded that the institutional structure affects the political leader’s policies on the distribution of resources toward the provision of both public and private goods. In detail, institutions with small winning coalitions discourage the provision of public goods that benefit the entire society. Bueno de Mesquita et al. (2002) explain that “these institutions also benefit leaders’ welfare in comparison with other systems that encourage the provision of public goods.”

2.5. Putting Together

This study has thus far reviewed several sets of literature individually to see what each academic discipline has explored that relate to the topic of this study. Based on these individual literature review, this section attempts to navigate how those individual literature speak to one another, so that a foundation can be constructed for generating testable hypotheses. In short, the financial development literature confirms the value of the development of cross-border M&A sector as a topic of scholarly endeavor. The business literature, on the other hand, offers all the basics for understanding the dependent variable of this study in general. The business literature nevertheless reveals one critical shortcoming, a factor which calls for the introduction of literature review in other disciplines: while the literature has exploited extensively on the impact of "institutions" on cross-border M&As it has not provided a clear definition of what it meant by institution. This in turn called for a clarification, which could be accomplished by reviewing the literature of relevant academic domains. On this note, the review of institution literature offered suggestions on the definition of institution, and that on varieties of capitalism suggested a number of ways to categorize capitalist economies as institutions.

First, the economics literature provided an extensive volume on financial development, e.g. the role of financial system in economy and its core function. Second, the management literature is where everything about the

rudiments of cross-border M&As is to be found. What is most intriguing for this particular paper would be the key driving force of cross-border M&As. Shimizu et al. (2004) summarize the key motives for which companies seek after the acquisition of companies abroad can be summarized in threefold: first, to enter foreign market; second, to learn from foreign business culture; and third, as part of their value-creating strategy.

Efforts have been made intensively to explore what leads companies to pursue a cross-border M&As. The literature suggests that among the most powerful influences in companies' decision are geographical proximity, the movement of currency values, stock market performances, and valuation (Erel et al., 2012). That is, the closer the two companies are located the more likely they are to be merged or acquired by each other; the higher the appreciation of currency values the more likely are those countries to attempt to acquire foreign firms.[12] Moreover, Erel et al. (2012) explains that "the greater the difference in stock market performance between the two countries, the more likely that firms in the superior-performing country purchase firms in the worse-performing country."

Within the diversity of most conspicuous topics in management literature is one directly related to the topic of this study: the importance of institutions in cross-border M&As. In essence, the lesson from the

[12] Likewise, the companies that are located in countries where the currency values have depreciated relatively more than other countries are more likely to be targeted by potential acquirers.

management literature is that what is perhaps decisive factor which determines the success of attracting cross-border M&A inflows is institution, or more precisely, the quality of institutions. Empirical evidence of 165 countries between 1997 and 2006 shows that countries with higher-quality institutions, namely developed countries, have attracted as much as ten times more inflows of cross-border M&A compared to the countries with inferior quality of institutions, i.e. developing countries (Hur et al., 2011). Institutional quality is determined based on several factors including, but not limited to, the degree of corruption by public officials, propriety of regulation, political stability, and the rule of law.

Another empirical finding suggests that the quality of political institutions matters for inflows of foreign direct investment (FDI), and it matters independently of the level of development of economy, i.e. gross domestic product (GDP) per capita (Bénassy-Quéré et al., 2007). And the supporting accounts are that, first, raising the standard of property rights and transparency can appeal to foreign investors thereby attracting more cross-border M&A inflows; second, bad institutions can incur unnecessary costs for potential investors in cross-border M&As, e.g. rent-seeking due to corruption; and third, low-quality institutions can exacerbate uncertainty in government policies and administration, and this in turn, can make the potential investors to cross-border M&As who are, by and large, vulnerable to uncertainty due to a relatively high sunk cost (Bénassy-Quéré et al., 2007).

Taken together, the financial development literature revealed that a well-constructed financial system is a vital prerequisite for growth, and that certain conditions should be met, e.g. the liberalization of financial system and markets, and democratization, in order to accomplish a successful financial development. This leads to a conjecture that cross-border M&A market is also an important part of financial system, which can contribute to growth. The central takeaway from the literature review is that the financial development literature backs up an idea of this study that the development of cross-border M&A sector is important.

The management literature demonstrated an "anatomy" of cross-border M&As. Among many, the literature has provided a forceful lesson on the importance of institutions, i.e. the quality of institutions, in attracting cross-border M&As. However, the literature has revealed that the business scholars have taken the concept of institution for granted, i.e. using the concept without the clarification of the conceptual parameter of the institutions. This calls for clarification of the concept of institutions used in the literature, which goes beyond the scope of this study. So this study limits its parameter to political institutions.

The VoC literature, on the other hand, has provided a useful conceptualization of capitalist economies and its taxonomy. There is obviously an ongoing debate about how to categorize the capitalist economies – most notably between a binary model or so-called a multiple model. The LME – CME

dichotomy of Hall and Soskice (2001) is a prime example for a binary model, while a few different models have been suggested to classify the capitalist economies in multiple forms.

For example, Dore et al. (1999) categorize the capitalist economies into four types. First, the British model shows a heavy family control over manufacturing corporations, ample supplies of locally concentrated and highly skilled craft workers"(p. 103), and a tradition of technical specialists and administrative staffs building managerial organizations within the company. Second, the key features of the American model include the separation of managerial control and corporate ownership, use of retained earning s as the "financial foundation for investing in the further growth of the industrial enterprise" (p. 104), and promotion of specialists to upper levels to manage the company.

Third, the German model boasts a considerable degree of educational preparation of work force for industrialization, "the diffusion of high-level scientific and technical education in the *technische hochshulen*" and the network of "*ingenieurschulen* for more practical skills" (p. 105), the role of leading commercial banks as the venture capital for the start-ups, and "a greater mobilization and further development of the capacity for collective action" such as compulsory membership in local chambers. Fourth and finally, the Japanese model reveals a "rapid creation of a high-quality system of higher education, supported by the state and pioneering industrialists" (p.105), and

"selection and concentration" as the base of industrial policies wherein a handful of domestic conglomerates (alias "*Zaibatsu*") inherited the ownership and the control over the state-owned enterprises.

Nevertheless, the contention seems to be overwhelmed by the typology offered by Hall and Soskice (2001) - LMEs and CMEs that are in a diagonal relationship. Other binary models of typology include 'stock market capitalism' versus 'welfare capitalism' (Dore, 2000), and 'shareholder capitalism' versus 'stakeholder capitalism' by Will Hutton (Hutton and Giddens, 2000). Some scholars, on the contrary, argue that the typology of capitalism requires a multiple model, i.e. three or more categories. For example, Pontusson (2005) argues that the Nordic economies deserve an independent categories as 'Social Market Economies (SMEs)', so there should be three categories – LMEs, CMEs, and SMEs. Lastly, the political institution literature provided useful clues to set the conceptual boundaries of institution for this paper, as well as accounts on the core aspect and function of institution.

Despite these telling lessons in the literature there still remains a gap to fill. First of all, the themes and lessons from the financial development literature remain rather broad and general in terms of its explanation on the development of particular financial sectors, e.g. cross-border M&A and derivatives market. Instead, the literature looks at the financial system as a whole. Secondly, despite tenacious efforts to understand the role and effect of institutions in cross-border M&As, the management literature falls short of

clarifying the concept of institution. Instead, the literature uses the concept of institution for granted and keeps the term vague, let alone specifying what aspects of institutions are being discussed. A brief review of the political institution was an ancillary measure to make up for the deficiency in the management literature. But such an auxiliary step still falls short of full clarification of the concept of institution in the management literature.

Moreover, the varieties of capitalism literature shows a critical limitation: a problem of external validity. That is, while the literature offers very useful concepts to understand the variety in the modalities of capitalism, one critical limit appears – the scope of capitalism used in the literature is strictly constrained to the developed countries. For example, the majority of works in this particular domain reveal propensity toward the western world, e.g. U.S., U.K., and western Europe. The only exception in the literature is Japan. This constrains the application of the concepts and the typology of capitalist economy to a wider set of countries, thus triggering an issue of external validity. Taken together, it seems mandatory to make efforts to put together the literature of different academic disciplines to be able to answer the research question in this study. The hypotheses may be inferred from the literature of different academic disciplines.

Part Three. Hypotheses

The central research question in this study is the relationship between political determinants and the development of cross-border M&A sector. In other words, this study aims at understanding what political factors contribute to or impede the development of cross-border M&A sector. The inquiry came about from the discovery of several gaps in the existing literature. For example, the scholarly efforts on the development of cross-border M&A sector, up to date, has born a stubborn propensity toward economic variables, i.e. attempts to expand the boundary of the explanatory variables for the development of cross-border M&A sector have been limited to economic factors. Although the management literature has delved into the relationship between the institutions and the development of cross-border M&A sector, the literature has been unsuccessful in offering the exact definitional boundary of the explanatory variable, i.e. the institutions.

There are nevertheless a number of reasons why one should delve into the political accounts on the development of cross-border M&A. First of all, the management literature sends a clear lesson that the role of institutions is crucial to the development of cross-border corporate M&As. In addition, the varieties of capitalism literature reinforced the lesson from the management literature, by showing that a difference in institutions can lead to different outcome in the capitalist world, as Hall and Soskice (2001) have shown regarding the LMEs and the CMEs' approach to various policy issues, e.g. labor

relations and wage bargaining, industrial policy, and monetary policy. Lastly but equally importantly, the political institution literature suggests that one of the core functions of institution is to arrange the terms and conditions of rational exchanges in every aspect of daily human lives. That said, this study infers from the literature review and hypothesizes as follows:

H1: Difference structures in political institution (e.g. presidential system vs. parliamentary system, political stability, and the magnitude of checks and balances) lead to different outcomes in the development of cross-border M&A sector.

H2: Democracy is positively associated with the development of cross-border M&A sector.

The two hypotheses can be disaggregated into the following.

H1-a: A presidential system is more supportive than the parliamentary system to the development of cross-border M&A sector.

H1-b: Constitutional limit on the number of years the executive can serve before new elections support the development of the cross-border M&A sector.[13]

H1-c: If the party of the executive branch has control over the legislature, then the development of cross-border M&A sector will be more successful compared to the case in which such control does not exist.

[13] See Table 4 for the row of the variable coded as "Finite Term."

H1-d: A plurality system in the legislative election is more conducive to the development of cross-border M&A sector than a system of proportional representation.[14]

H1-e: The longer a country has been in a certain system, whether democracy or autocracy, the more likely this country experiences a successful development of cross-border M&A sector.[15]

H1-f: Checks and balances between the executive branch and the legislative branch support the development of a cross-border M&A sector.[16]

H1-g: The fewer veto players there are the more successful the development of a cross-border M&A sector.[17]

H2-a: The stronger a guarantee of the freedom of speech and association for citizens as well as the protection of human rights, and the stronger the accountability of the public officials, the more likely a country is to experience a successful development of cross-border M&A sector.[18]

H2-b: The quality of bureaucracy is positively associated with the development of cross-border M&A sector.[19]

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[14] See Table 4 for the rows of the variables coded as "Upper House" and "Lower House."
[15] See Table 4 for the row of the variable coded as "Tensys."
[16] See Table 4 for the row of the variable coded as "Checks."
[17] See Table 4 for the row of the variable coded as "Stabs."
[18] See Table 4 for the row of the variable coded as "Voice and Accountability."
[19] See Table 4 for the row of the variable coded as "Government Effectiveness."

H2-c: The higher the degree of fairness and transparency of the regulatory system, the more likely a country is to experience a successful development of cross-border M&A sector.[20]

H2-d: The degree of rule of law[21] *is in a positive relationship with the development of cross-border M&A sector.*[22]

H2-e: The level of corruption among public officials is inversely related to the development of cross-border M&A sector.[23]

[20] See Table 4 for the row of the variable coded as "Regulatory Quality."
[21] Rule of law here encompasses the following categories: the level of crime, fairness of judicial process, enforceability of contracts, speediness of judicial process, history of confiscation, intellectual property rights protection, and the protection of private ownership.
[22] See Table 4 for the row of the variable coded as "Rule of Law."
[23] See Table 4 for the row of the variable coded as "Control of Corruption."

Part Four. Methods and Data

This study uses a mixed method that combines of statistical analysis and comparative case studies. The quantitative method is applied primarily to test hypotheses using fixed effects model. In statistical analysis of panel data (see **Table 1** for snapshots of the data), or cross-sectional time-series data, either random effects model or fixed effects model can be used. The key difference between the two models is that while random effects model assumes that the dataset is made up of a group of population wherein a hierarchy of some sort define the differences amongst one other in the population, fixed effects model assumes that some country-specific factors can bias both the independent and dependent variables thus need to control for this. Moreover, the fixed effects model assumes that the time-invariant features of each country in the dataset are specific to that particular country and should not be correlated with other country-specific characteristics. To determine which model to use, Hausman test **(Table 2)** was conducted and the test result suggested the use of fixed effects model, i.e. p-value was smaller than 0.05 (p-value: 0.04884).

The qualitative method, by contrast, is used to investigate what the real-world examples say about the details of the outcome of the statistical analysis, i.e. a cross examination. That said, the dependent variable in this study is the cross-border M&A inflows. The independent variables are mainly concerned with political institutions and democracy. For instance, the variables

regarding political institution examine the system (presidential vs. parliamentary), legislative structure (unicameral or bicameral), whether there is a constitutional limit regarding the term in executive office, whether there are actual checks and balance in politics, or the percent of veto players who drop from the government in any given year.

The operationalization of the explanatory variables on democracy relies on the Economist Intelligence Unit (EIU), particularly the Unit's Democracy Index. The Index is based on the view that "measures of democracy that reflect the state of political freedoms and civil liberties are not thick enough", i.e. "[t]hey do not encompass sufficiently, or, in some cases, at all, the features that determine how substantive democracy is" (p. 43~44).[24] The EIU, in its 2015 report, explains that the Index is based on five categories: "electoral process and pluralism; civil liberties; the functioning of government; political participation; and political culture" (p. 44). This is because "[t]he condition of holding free and fair competitive elections, and satisfying related aspects of political freedom, is clearly the *sine qua non* of all definitions" of the modern democracy (p. 44), the EIT argues. Each category has a rating on a zero to ten scale, and "the overall Index is the simple average of the five category indexes." The EIU adds that "[t]he category indexes are based on the sum of the indicator scores in the category, converted to a 0 to 10 scale" (p. 45).

[24] The EIU's Annual Report on Democracy Index 2015 (http://www.yabiladi.com/img/content/EIU-Democracy-Index-2015.pdf)

Accordingly, the variables regarding democracy in this study examine five factors. First, 'voice and accountability' variable concerns the depth of vested interests, accountability of public officials, human rights, and freedom of association. Second, a 'government effectiveness' variable is concerned with the quality of bureaucracy and institutional effectiveness, and the degree of bureaucracy (i.e. whether there is 'red tape' involved). Third, a 'regulatory quality' variable is related to the fairness in competitive practices, price controls, discriminatory tariffs, excessive protections, and discriminatory taxes. Fourth, a 'rule of law' variable concerns violent crime, organized crime, fairness and speediness of judicial process, enforceability of contracts, confiscation, protection of intellectual property rights, and private property protection. Lastly, the 'control of corruption' variable concerns corruption among public officials.

The operationalization of the independent variables on political institutions counts on The Database of Political Institutions, which was compiled by the World Bank's Development Research Group. The database has 125 explanatory variables, including the ones used in this study, and these variables are sorted into five different group – first, chief executive variables; second, political party variables; third, electoral rules variables; fourth, stability and checks and balances variables; and fifth, federalism variables. Lastly, several factor had been controlled for to avoid the distortion of result, e.g. GDP growth, exchange rate, and inflation.

The panel data used in the statistical analysis of this study is established based on a variety of data sources, and covers 167 countries between 2002 and 2012. The M&A data are collected from an online database of the United Nations Conference on Trade and Development (UNCTAD STAT)[25]. The data for the political institution variables are collected from the Database of Political Institutions 2012[26] and Beck et al. (2001). The democracy variables are collected from the Economist Intelligence Unit.

The parameter of the panel data was finalized based on a single criterion – minimizing the impact of missing data problem. Several sets of raw data were gathered from various sources, and were examined for comparability. Initially, the raw datasets included approximately 215 entities (two hundred plus countries and about a dozen of other entities[27]), and the time spanning from 1960 to 2015. The datasets were than sorted to come up with the so-called "least common denominator" which can rule out as many blanks as possible. The result was 167 countries in eleven years of timespan (2002~2012).

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[25] UNCTAD STAT: United Nations Conference on Trade and Development Online Statistics Database (http://unctadstat.unctad.org).

[26] The Database of Political Institutions is available at the World Bank Online Database on Development Research (http://econ.worldbank.org/WBSITE/EXTERNAL/EXTDEC/EXTRESEARCH/0,,contentMDK:20649465~pagePK:64214825~piPK:64214943~theSitePK:469382,00.html)

[27] "Other entities" include the following: first of all, non-sovereign independent economies like Hong Kong and Macau, both of which are the Special Administrative Region of the People's Republic of China; second, newly-born sovereign states like the Republic of South Sudan; third, vanished states like the Democratic Republic of Germany (East Germany) and Czechoslovakia; fourth, statistically unreliable states like Eritrea and the Democratic People's Republic of Korea (North Korea); and finally, marginal entities (in the financial world) with significant degree of missing data such as the Arab Republic of Yemen, Cape Verde, Macedonia, Palau, San Marino, Sint Eustatius and Saba Bonaire, Somalia, Tajikistan, Timor-Leste, Turks and Caicos Islands, and Tuvalu.

Part Five. Statistical Analysis

The statistical analysis tested the following model using the fixed effects model: the dependent variable is the cross-border corporate M&A inflows, and the independent variables are related to democracy and political institutions.[28]

$$\boldsymbol{y = \alpha x_1 + \beta x_2 + \gamma x_3 + \delta x_4 + \varepsilon x_5 + \cdots + \lambda x_{11} + \mu x_{12}}$$

In essence, the result (N=228) suggests that democracy matters greatly for the development of cross-border M&A market, i.e. democracy contributes to the development of cross-border M&A sector. Specifically, the democracy-related explanatory variables were found to be positively associated with the development of cross-border M&A sector, except the "government effectiveness" variable, which refers to the quality of bureaucracy and the thickness of "red tape." Conversely, political institutions were found to be irrelevant to the development of cross-border M&A sector. This is mainly because the relationship discovered in this test were statistically insignificant for all the explanatory variables of political institution. In **(Table 8)**, the coefficient (1466.665) shows that the degree of democracy, which was operationalized by the Democracy Index, is positively associated with the development of cross-border M&A sector. In detail, the statistical analysis showed that, regarding the voice and accountability (coded as VA), the higher the accountability of public officials, protection of human rights, and the degree of freedom of

[28] Refer to the Appendix for the details of the explanatory variables.

association, the better the cross-border corporate M&A sector is developed **(Table 4)**. This result was statistically significant.

With regard to the regulation (coded as "RQ"), the analysis demonstrated that what contributed to the development of cross-border M&A sector were the fairness in competitive practices, effective price controls and discriminatory tariffs, controlling excessive protection, and discriminatory taxes – all of which were grouped into one indicator that was named as "Regulatory Quality" (RQ). The quantitative analysis also revealed that suppressing corruption amongst government officials (coded as "CC") contribute significantly to the development of cross-border M&A sector, as the magnitude of control on corruption was in a positive relationship with the dependent variable.

The test also revealed that the rule of law (coded as "RL") is in a positive relationship with the cross-border M&A sector: strict suppression over crime, intellectual property rights violation, and confiscation led to more successful development of cross-border M&A sector. On the contrary, the effectiveness of government administration (coded as "GE") yielded a negative coefficient, i.e. the degree of effectiveness of the administrative institution is inversely related to the development of cross-border M&A sector. This particular result was statistically significant.[29]

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[29] This is a counterintuitive, thus interesting, result which calls for further exploration in other research opportunity, since it goes beyond the scope of this particular study.

By contrast, the statistical analysis demonstrated that political institutions wield very weak influence at best to the development of cross-border M&A market around the world. This is because the political institution variables were statistically insignificant. That said, the statistical analysis on the relationship between political system revealed that the countries with a constitutional limit, on the number of years the executive can serve before new elections are called, yielded a superior result in the development of the cross-border M&A sector **(Table 4)**. This finding bears a problem of statistical insignificance thus ruled out. With regard to the legislative system, the result of this quantitative analysis suggested that the countries in which, when it comes to the electoral rule for the legislature, the rule of proportional representation, as opposed to the plurality rule, led to a better result in the development of cross-border M&A sector **(Table 4)**. Next, regarding the stability of political system as well as checks and balances of power the analysis demonstrated that the longer any given country has been democratic the better result was brought about for the development of the cross-border M&A sector. This result was statistically insignificant **(Table 4)**.

In sum, the statistical analysis showed that democracy, or the degree of democratization, is significantly influential to the development of the cross-border M&A sector. Specifically, several aspects of democracy – voice and accountability, the quality of regulatory framework its enforcement, the rule of law, corruption control, and the effectiveness in the government

administration – all contribute to the development of cross-border M&A market. On the contrary, how political institution is designed does not appear to influence the development of cross-border M&A sector. While the statistical analysis yielded certain correlation between the explanatory variables of the political institution domain, these relationships were not meaningful due to its statistical insignificance.

Part Six. Case Studies

This section conducts comparative case studies on the Republic of Korea (henceforth Korea) and Japan. This East Asian pair forms, what is called in comparative politics, a most different systems design of comparative case studies. In short, the two countries form a most different systems design because difference in the longevity of the political regime and political institutions led to a successful development of cross-border M&A sector in both cases. Japan represents a case of long-lived democracy, parliamentary system, and an industrialized economy, while Korea is a case of rather nascent democracy, presidential system, and a developing economy. But both countries yielded a successful development of cross-border M&A sector. The section looks at the two cases individually and then compares to derive key lessons.

6.1. Japan

6.1.1. Cross-Border M&A

Japan is the pioneer of modern finance in Asia. The nation thus has had a modern financial system and financial institutions that date back to mid-nineteenth century when the national movement for modernization, or Meiji restoration of 1868, took place. Likewise, Japan has developed a financial system that is sustained by three key pillars and is bank-based. The three pillars were commercial banks, life insurance, and government-owned financial institutions (Hoshi and Kashyap, 2004). The origin of such design of

financial system is still under exploration, but what seems apparent is that the cross-border M&A sector emerged in a severely lagged manner, i.e. while the exact time is unknown, there is a tacit consensus amongst professionals that the cross-border M&A sector in Japan did not hit its stride until the 1990s.

Instead, the Japanese financial system has developed with certain characteristics, including the bank-centered structure. The Japanese financial system emerged during the early 1950s as the country struggled to bounce back from the aftermath of the World War II. The Japanese financial system experienced, until the early 1970s, tight regulation, severe competition in the banking sector, and an active role of government in directing loans.

Another notable feature of the Japanese financial system in this era was a rapid growth without international capital. Several factors enabled this to happen, according to Teranishi (1994): first, Japan's balanced budget policy and a relatively low share of government expenditures in GDP; second, international capital markets were underdeveloped; third, a scarcity in Japan's foreign reserves discouraged the Japanese government to reach out to the international capital market; fourth, the rapid growth of Japanese exports reduced the necessity of replenishing foreign exchange by way of importing capital; and fifth, Japan's strict regulation of international capital transactions provided a necessary condition for sustaining the financial system.

Sakakibara and Feldman (1983) explain that the Japanese financial system created distinctive characteristics during this period. To begin with,

debts deepened consistently, mainly due to the shortage of capital. Second, the government maintained a high degree of intermediation by directing the allocation of financial resources. Third, the government insisted on keeping public debt at a low level. Lastly, low levels of credit for individual consumers and small businesses.

Decades of rapid growth transformed Japan to a developed economy. The financial liberalization set on with Japan's economic accomplishment since the early 1970s. Several key features of Japan's deregulation are worth noting. First, the money market was expanded as new financial instruments were introduced, e.g. certificate of deposit (CD), treasury bills, and commercial paper (CP). Second, such introduction of new financial instruments triggered the deregulation of deposits at commercial banks, trust banks, long-term credit banks, and the postal savings. Third, the government bond market was deregulated due to the issuance of a large sum of revenue-financing bonds in 1975 (Patrick and Park, 1994).

The internationalization of Japanese financial system unfolded in tandem with deregulation. The enactment of a new Foreign Exchange and Foreign Trade Control Law of 1980 lifted the ban on international financial transaction in the Japanese financial markets. This measure, in principle, offered a full-scale freedom of international financial transaction by Japanese and foreign entities alike. Moreover, Tokyo lifted the restriction on currency swaps in 1984, i.e. the restriction which curbed the amount of foreign currency

that could be converted to the yen by the financial institutions. In the same year, Japan repealed the "real demand doctrine" so as to encourage forward exchange transactions. Previously, the doctrine allowed forward exchange transactions for only trade.

It is within this tide of liberalization that the cross-border M&A sector in Japan grew. According to RECOF[30], the cases of cross-border M&A in Japan grew from 195 cases in 1986 to 643 cases in 2013. During these period, the inbound M&A market grew by tenfold while the outbound market grew by 2.75 times.[31] Some characteristics are worth noting with regard to Japan's cross-border M&A market: first, rapid expansion of the market in the mid- and late-1980s; second, steady but gradual development of the market in the 1990s; third, rapid surge around the turn of the millennium; fourth, steady market situation in the 2000s; and fifth, sharp decline in the late 2000s following the Great Recession.

Bebenroth (2015) explains that although the international investors made their inroads into the Japanese market as early as early 1960s, their mergers and acquisitions attempts were largely unsuccessful mainly due to "informal hindrances." That is, "even though a foreign firm may offer more advanced technology, they still may not be able to compete with a Japanese

[30] RECOF (www.recof.co.jp) is a Japanese consulting firm specializing in corporate M&A. The data was sourced from several issues of RECOF's M&A database (1986-2014).
[31] The cases of foreign corporations acquiring Japanese firms grew from only 14 cases in 1986 to 149 cases in 2013. On the other hand, the cases of Japanese companies acquiring companies abroad grew from 181 cases in 1986 to 499 cases in 2013, according to RECOF.

firm" because Japanese firms has competitive advantage in "software", e.g. brand image, understanding on particular behavioral patterns of Japanese consumers, etc.

With regard to the development of cross-border M&A sector in Japan, Bebenroth (2015) argues that the expansion of cross-border M&A sector in Japan in the late 1980s was attributable to Japan's economic bubble. Also, the sharp expansion of the sector in the late 1990s results from the Asian financial crisis of 1997-98. That is, a disastrous collapse of the Asia's financial market during the crisis diverted the interests of the international investors to a "safer" market, and as a consequence the international capital turned to Asia's most advanced market to invest. Lastly, a drastic plunge of the cross-border M&A sector in Japan after 2008 was a consequence of the Great Recession, Bebenroth added.

6.1.2. Political Institution

Japan is officially a constitutional monarchy with bicameral legislature. The emperor is the symbolic leader of the nation, and the prime minister is the head of government and the chief of the ruling party. This democratic nation with a parliamentary system features a bicameral structure in the legislature – House of Councillors (参議院. Upper House) and House of Representatives (衆議院. Lower House). Just like in any other country with parliamentary system, the head of the party which wins the legislative election takes the

prime minister position, i.e. no limit on the number of continuous terms one can serve in office. This enables the executive branch in Japan to wield control of the legislature. Consequently, checks and balances is functioning rather in an "one way" style than in a "two-way street" style the institutional frameworks of Japanese politics.

The party system in Japan is multi-partisan, i.e. several parties are represented in the legislature. However, one party has monopolized the control of the executive in the postwar era except for a few years: the Liberal Democratic Party (LDP. 自民黨) monopolized the prime minister's office since 1947, and the prime ministers from other parties ruled for a total of six years during this period.[32]

6.1.3. Democracy

The Economist Intelligence Unit ranks Japan as the 23rd among one hundred and sixty-seven countries in the world in 2015, or a "flawed democracy" in terms of democracy. The country's score was 8.08 in the Economist's

[32] The first non-LDP rule came about in August 1993, as Hosokawa Morihiro of Japan New Party (日本新黨) sworn in. Hata Tsutomu (日本新生黨 Japan Renewal Party) and Murayama Tomiichi (日本社會黨. The Socialist Party of Japan) succeeded Hosokawa in order. This non-LDP rule ended in January 1996 as the LDP reclaimed the Prime Minister's Office. The second non-LDP rule came in September 2009, as the Democratic Party of Japan (DPJ. 日本民主黨) surprised the nation with a landslide victory in general election. As a consequence, three DPJ politicians – Hatoyama Yukio (鳩山由紀夫), Kan Naoto (管直人), and Noda Yoshihiko (野田佳彦) led Japan for about three years total. But the LDP, once again, recaptured the Prime Minister's office in 2012 general election. Since then Abe Shinzo (安倍晋三) has been serving as the prime minister.

Democracy Index in 2012.[33] The magazine constructed the Index based on five components - electoral process and pluralism, civil liberties, the functioning of government, political participation, and political culture. The Economist explains that "[b]ased on their scores on a range of indicators within these categories, each country is then itself categorized as one of four types of regime: 'full democracies', 'flawed democracies', 'hybrid regimes', and 'authoritarian regimes'." Further analysis of Japan's democracy will follow below.

6.2. Republic of Korea

6.2.1. Development of Cross-Border M&A Sector

The cross-border mergers and acquisitions is a recent phenomenon in Korea. Once the flagship of the Asian Tigers, the foreign acquisitions and mergers of Korean corporations became salient only after the onset of the financial crisis of 1997-98. Before the crisis, the Korean financial system was rather secluded from the international financial market.

The modern financial system was introduced in the late 1800s as the first modern financial institution (조흥은행. Chohung Bank) was established in 1897 by the royal family of the Chosun Dynasty. During Japanese occupation (1910-1945) the Korean financial system mainly functioned in various roles assigned by the Japanese Government-General. And the

[33] The Index is computed in a zero to ten scale.

development of the current financial system in Korea began as Korea became an independent republic in August, 1945.

During the early years of the Republic of Korea, the financial system remained underdeveloped. The core achievement during this period would be the establishment of the Korea Development Bank (한국산업은행), the government's main financial vehicle for industrial policies. And the development of the financial system emerged as Park Chung-hee (박정희) usurped power in 1961. As the nation's leader, Park put forth 'poverty eradication' as the top priority of his leadership, and aggressively pursued economic development policies. For example, the Park administration reorganized the agricultural financing and marketing institutions by combining the agricultural cooperatives and the Agricultural Bank into one entity – National Federation of Agricultural Cooperatives (NFAC. 농업협동조합중앙회). Also, the government established the Industrial Bank of Korea (IBK. 중소기업은행) to funnel loans to the small and medium enterprises.

The build-up of financial system by the Park administration continued into the late 1960s, as the Korea Exchange Bank (KEB. 한국외환은행) was established in January 1967 to support Korean companies' export. On a par, the government licensed the establishment of local banks so as to serve the financial needs of local entities. The 1970s saw the establishment of non-

banking financial institutions (NBFIs), e.g. development institutions like Export-Import Bank of Korea (한국수출입은행), mutual savings bank, and credit unions.

Capital market development hit its stride in tandem with the development of other financial sectors. With the launch of the Capital Markets Fostering Act in 1968, major corporations, or the subsidiaries of *Chaebols*, went public to the Korea Stock Exchange (KSE). The government applied several policy measures to encourage the initial public offerings (IPOs) of domestic firms, e.g. favorable tax treatments. Although the government concentrated intensively on the construction of the financial system it maintained a heavy interventionist position. For example, the government set daily limits on the price of listed stocks and bought back the government and public bonds. In addition, the government issued guarantee for corporate bonds (Cole and Park, 1983).

Park Chung-hee's term ended in October 1979 due to assassination by his spy chief – Kim Jae-kyoo, then the head of the Korean Central Intelligence Agency. And his successor - Chun Doo-hwan - carried on with the legacy of Park, by pursuing economic development. The 1980s and 90s saw a full-scale financial liberalization in Korea. For example, CP was introduced in 1981 and the government-owned commercial banks were privatized between 1981 and 1983. Also, entry barriers to the financial industry were significantly lowered

in 1988, and the ban on foreign ownership of domestic insurance and securities firms was lifted also in 1988. In addition, several measures to liberalize the capital account and the foreign exchange market were put in place between 1980 and 1992, e.g. revision of FDI policies from the positive system to the negative system (1984), the establishment of foreign exchange call market (1989), and the launch of the Market Average Exchange Rate system (1990). Park (1996) explained that the "current account surpluses in 1986-89 provided further impetus to deregulate foreign exchange transactions in areas such as position management, documentation requirements, and the international use of the won" (p. 251).

The 1990s was the era of ferment in Korea's financial system. A rapid economic growth in the previous decade endowed a cumulating corporate debts, and the accumulation of debts continued well into the 1990s. And as the financial crisis swept Asia in 1997, Korea became one of the most severely struck economies, mainly due to a festered problem of excessive short-term borrowing which, in turn, led to debt maturity mismatch. The Korean economy, after being bailed out by the International Monetary Fund in December 1997, was able to bounce back in a few years thanks to the faithful compliance to the IMF's bailout conditions.

The biggest legacy of the Asian financial crisis and the experience of the IMF bailout was an unprecedented liberalization of the financial system. Particularly, as part of compliance to the conditionality of the Fund's bailout,

Korea witnessed foreign ownership of domestic financial institutions for the first time. The emergence of foreign ownership in the financial sector is part of international capital's investment in distressed assets (Mody and Negishi, 2000). For example, Germany's Commerzbank purchased the controlling share of Korea Exchange Bank in 1999, and Lone Star Fund (a Dallas, Texas-based private equity fund) acquired the German's KEB share in 2003. Moreover, Korea First Bank (KFB. 제일은행), one of the most gravely damaged financial institutions by the Asian financial crisis, was taken over by New Bridge Capital – a San Francisco, California-based private equity fund (PEF). KFB held a massive sum (17 trillion won, or approximately US$ 18bn) of toxic assets to the *Chaebols*, e.g. Daewoo Group (then the second largest conglomerate in Korea) and Hanbo Group (Korea's construction giant).

Today, Korea reveals one of the largest foreign presence in Asia. For instance, six of the seven commercial banks have foreign majority stakes (including two wholly-owned foreign banks), about a third of securities firms are foreign-owned, and about one fifth of the life insurance industry is owned by foreign capital. Most recently, China's Anbang Insurance acquired one hundred percent of Germany's Allianz Insurance, Korea in April 2016.

6.2.2. Political Institution

Korea is a presidential republic with unicameral legislature, where the president is the head of state. The Korean presidency is subject to

constitutional limit, which shows contrast with Japan – single term of five years. Korea's National Assembly (대한민국 국회) is elected every four years, and has three hundred members. Among them, two hundred and fifty-three members represent their constituency and are elected by the plurality vote. Forty-seven members are elected through proportional party votes. Such institutional structure in Korea allows for strong checks and balances.

Korea features a multi-party system: while there are more than a dozen political parties registered to the National Election Commission, the two major parties (Saenuri Party and the Democratic Party of Korea), in reality, split the Assembly into halves – 157and 127 seats, respectively. Just like in any other presidential system, the legislative majority does not always take the executive branch. But when the ruling party occupies the majority in the legislature, it enables the executive branch in Korea to wield control over the legislature. Consequently, checks and balances may function imperfectly in the institutional frameworks of Korean politics.

6.2.3. Democracy

The Economist Intelligence Unit ranked Korea as the 22nd among one hundred and sixty-seven countries in the world in 2015, or a "flawed democracy." Korea's Democracy Index was gauged 8.13, as in zero to ten scale, in 2012.

6.3. Discussion

The two cases form the most different systems design: a pair of different cases yield very similar outcomes in terms of the development of cross-border M&A sector. In a nutshell, Japan was an industrialized economy with a long history of democracy that adopted a parliamentary system. And her experience of cross-border M&A sector development was unfolded as a consequence of economic boom, which is a natural phenomenon in the modern capitalist economy. Conversely, Korea was a developing economy with a short history of democracy that adopted the presidential system. Moreover, Seoul's experience of the development of cross-border M&A sector set on as a consequence of external pressure, i.e. the bailout conditions imposed by the IMF at the time of the Asian financial crisis. Although there had been fierce public wrath about the conditions demanded by the Fund, the Korean government infused forceful thrust in pushing forward its policy to cope with the aftermath of the Asian financial crisis through the bailout. This was possible mainly due to the fact that she had adopted presidential system, i.e. the executive branch could concentrate its authority and resources on pushing forward its decision to take the IMF bailout with little to no domestic vetoes. Regardless, both economies have reached a status of advanced M&A markets in the world. In sum, this study suggests that the two different cases both yielded a successful development of cross-border M&A sector mainly due to a fact that both are democracies.

First of all, Japan was already in the status of a highly industrialized economy when the development of cross-border M&A sector began in earnest in the mid-1980s. In addition, Tokyo already had a long legacy of modern political and economic institutions, which dates back to 1868 when the Empire of Japan established constitutional monarchy. This meant that the politics and the economy in Japan would operate in a systemized way rather than in a discretionary or random way. As mentioned earlier, Japan had already become the home of an economic 'miracle' in the 1970s, thus joined the elite club of the world economy – namely the Group of Seven (G7) along with Canada, France, Germany, Italy, the United Kingdom and the United States.

On this note, the development of cross-border M&A came about as part of a natural consequence of economic boom. That is, as the economic boom in the 1970s carried on into the following decade, the mergers and acquisitions of Japanese firms by international capital also prospered. In sum, Japan's case of the development of cross-border M&A sector took place in an environment of highly industrialized economy, or a developed economy, and took place as part of natural consequence of economic boom. On the contrary, the development of the cross-border M&A sector in Korea hit its stride when Korea was in the developing country status[34], and especially when the Korean economy was in horrendous crisis. Moreover, unlike in Japan where the

[34] Korea is still considered to be a developing economy and not a developed economy, although equally many consider Korea to be among the leaders of the developing economies.

development of cross-border M&A sector occurred as part of the consequence of economic boom, i.e. a natural phenomenon in economy, the development of cross-border M&A sector was rather forced.

That is, the Korean economy was under strict intervention and control by the government since its development unfolded with the emergence of military dictatorship in 1961. Since then, every corner of the Korean economy was under government control as the military government aggressively pursued development and economic growth. Along this process, the Korean financial system subordinated to the government mandates and mainly served as capital funneling channel through the aforementioned government financial vehicles. This was possible mainly because Seoul had a short history of democracy and modern capitalist economy, though growing at a rapid pace, so much so that the politics and the economy were operated on less systemic way and more or less on discretionary manner. In other words, the Korean case shows that Seoul was able to reach out for the IMF bailout over a fierce public wrath because the executive branch could wield a greater level of authority in pushing forward their policy objectives without strong vetoes, and also because a relative short legacy of democracy endowed the president with discretion to attain his policy goals without dealing with the resistance from the oppositions.

This was the basic environment of the Korean economy and financial system throughout the military dictatorship era (1961-1993). During this period, the Korean economy accomplished success of what many people call the

"miracle of the Han River." But the darkness of the economic success lingered on as Seoul achieved accomplished a transition to democracy in 1993, and a persisting issue of mounting corporate debts doomed the Korean economy to the Asian financial crisis of 1997-98.

It is after the 1997 financial crisis destroyed the entire Korean economy when the development of cross-border M&A sector started. Specifically, contrary to Japan, where the cross-border M&A sector developed as a consequence of economic boom, Korea's cross-border M&A sector was developed by force. When the IMF approved Korea's application to bailout, the Fund mandated a wide array of conditions to be fulfilled by the Korean government in exchange for the bailout, e.g. bailout conditionality. In a nutshell, the IMF's conditionality mandated the "restructuring" of the entire economy to improve the overall 'efficiency' and 'transparency' of the economy. For example, the Fund mandated that the Korean government direct a so-called "Big Deal" amongst the *Chaebols*, so that those conglomerates improve the efficiency of their business portfolio. Also, the IMF ordered that Seoul free the financial system by lifting a wide range of bans that had been in place for decades. It is within this category which the IMF pried open Korea's financial markets, and along this particular process the development of cross-border M&A sector emerged. The aforementioned foreign acquisitions of Korea's

domestic commercial banks, e.g. Korea Exchange Bank, Korea First Bank, and Citi Group's acquisition of Hanmi Bank in 2004.[35]

Next, the two Asian economies reveal a sharp contrast with regard to political institutions. On one hand, Japan uses parliamentary and bicameral system wherein the majority party in the legislature possesses the prime minister position, and also wherein a constitutional limit on the term of prime minister is absent. So checks works only one way – from the executive to the legislature. On the other hand, Korea adopts presidential and unicameral system wherein the president (the head of state and the head of the executive branch) and the lawmakers are elected separately. So the checks and balances work both ways between the executive branch and the legislature, and when the opposition party(ies) possess the majority in the National Assembly the checks and balances work even stronger than in the case which the same party possesses the president position and the majority in the legislature.

Party system is another point of contrast between the two nations. Both countries adopt multi-party system wherein unlimited number of political parties can coexist, at least in theory. However, Japan has been experiencing a de-facto single-party dominance while Korea showed a frequent expansion

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[35] This paragraph is sourced from various news articles in online archive. http://newslibrary.naver.com/search/searchByKeyword.nhn#%7B%22mode%22%3A1%2C%22sort%22%3A0%2C%22trans%22%3A1%2C%22pageSize%22%3A10%2C%22keyword%22%3A%22IMF%20%EA%B5%AC%EC%A0%9C%EA%B8%88%EC%9C%B5%20%EC%A1%B0%EA%B1%B4%22%2C%22status%22%3A%22success%22%2C%22startIndex%22%3A1%2C%22page%22%3A1%7D (Accessed 2:32pm, PST on March 26, 2016).

and contraction of the party system. That is, in Japan the Liberal Democratic Party (LDP) has dominated the National Diet, except for about six years in total, since current constitution was inaugurated in 1947, thus nearly monopolizing the prime minister position. Conversely, in Korea several parties coexisted although there was a clear division between major parties and minor parties. But even within the circle of major political parties, numerous factions have allied and dis-allied with one another frequently. For 2016 general election twenty-four parties have joined the race, including four major parties and twenty minor, or even mini parties.

In reverse to the other variables investigated in this paper, democracy shows the lowest degree of difference between the two countries. As mentioned earlier, both Korea and Japan are democracies, although Japan has been in democracy for much longer than Korea. And both countries are categorized as "flawed democracy" by the Economist Democracy Index.[36] The level of democracy in the two countries has been more or less the same during the period of interest in this paper: 2002~2012.

[36] The Democracy Index ranked Korea and Japan 22nd and 23rd, respectively for 2015. The Index groups the countries into four, and the 'flawed democracy' is the second from the top. The four categories are 'full democracy' (rank 1~20), 'flawed democracy' (rank 21~79), 'hybrid regime' (rank 80~115), and 'autocratic regime' (rank 116~167). Other 'flawed democracy' includes Belgium, Chile, France, Israel, Italy, Taiwan, etc. 'Full democracy' includes Britain, Canada, Germany, Mauritius, the Netherlands, Scandinavian countries (Finland, Norway, and Sweden), Uruguay, U.S., etc.

Part Seven. Conclusion

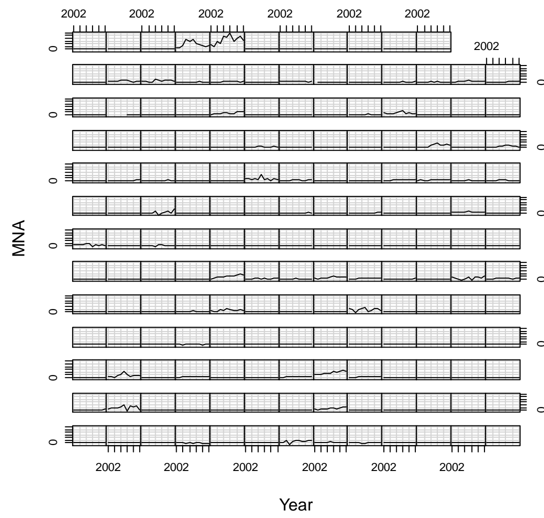
This study has explored the yet-underexploited arena of the studies in the development of cross-border M&A sector around the world, particularly the political economy of the development of cross-border mergers and acquisition sector. In doing so, I have applied a mixed method to examine the research question. The quantitative analysis, on the cases of 167 countries between 2002 and 2012, suggests that democracy wields a great deal of influence in the development of the cross-border M&A sector. As mentioned earlier, this is mainly because of the democracy's capability of protection of property rights and private ownership, as well as its superior transparency which, in turn, provides a better predictability of future.

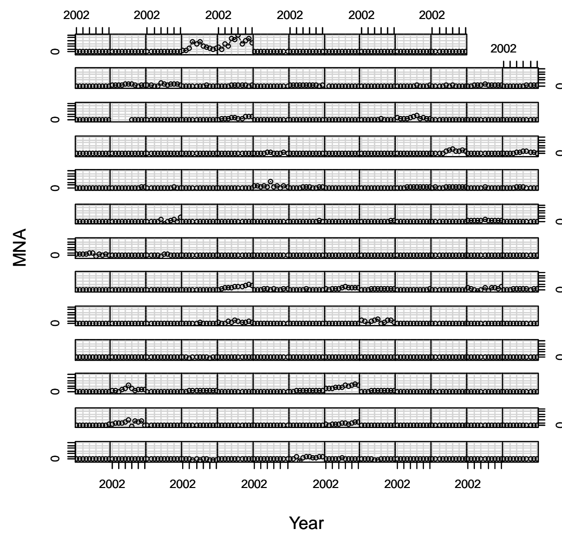
The latter part of this study looked into a pair of East Asian cases – Korea and Japan - to examine what the real-world examples say about the statistical test of the research question. The pair showed that although they are much different in various aspects, e.g. political institutions, party system, etc., they yielded similar outcomes: despite these differences the two countries have yielded a well-crafted and vibrant cross-border M&A sector. And the most notable difference between Korea and Japan from the thrust of the development: while the development of cross-border M&A sector in Japan was made possible mainly owing to a natural consequence of its economic boom in 1970s and 80s, that in Korea came about as a consequence of external pressure, i.e. IMF bailout conditionality.

This study has left several things to ponder on as the scholarship on the cross-border M&As moves forward. Among them is a call for increased scholarly attention: scholars should pay more attention to the political aspects of cross-border M&A. This is because the “rules” of which govern this type of international financial business is being determined not in the business arena but in the political sphere. And there are obviously certain types “rules of business” that are favored by the international investors in cross-border M&A over other types, thus looking at the political environment / conditions / institutions / from which those favorable rules of M&A business come will be of utmost importance.

Appendix

(Table 1) Snapshots of the Data





(Table 2) Hausman Test

Hausman Test
Data: MNA ~ system+finittrm+housesys+sensys+tensys+checks+ …
Chisq=19.753, df=11, **p-value=0.04884**
Alternative hypothesis: one model is inconsistent

(Table 3) Random Effects Model

Coefficients:				
	Estimate	**Std. Error**	**t-value**	**Pr(>|t|)**
(Intercept)	956.1629	11460.4837	0.0834	0.933587
System1	-6352.7413	5843.1437	-1.0872	0.278166
Finite term	-2308.3653	7758.4261	-0.2975	0.766350
Lower house	-2554.6144	3250.7988	-0.7858	0.432829
Upper house	-9.8714	11.2730	-0.8757	0.382193
System longevity	349.9216	115.7738	3.0225	0.002813**

Checks and balances	886.0858	560.7245	1.5803	0.115526
Stability	-2015.2537	3641.3952	-0.5534	0.580547
VA	28608.2737	13488.9632	2.1209	0.035084*
GE	-21329.0858	10375.3259	-2.0558	0.041020*
RQ	7062.9752	13295.6417	0.5312	0.595814
RL	-21645.5933	14303.1200	-1.5133	0.131667
CC	19046.2026	9081.9053	2.0972	0.037154*

(Table 4) Fixed Effects Model

Coefficients:				
	Estimate	Std. Error	t-value	Pr(>|t|)
Voice and Accountability	58104.68	20656.95	2.8128	0.005432**
Government Effectiveness	-28314.60	13468.14	-2.1023	0.036855*
Regulatory Quality	19645.55	23833.15	0.8243	0.410816
Rule of Law	6716.96	23760.12	0.2827	0.777719

Control of Corruption	27868.82	14703.86	1.8953	0.059582.
Finite Term[37]	-1526.41	10987.28	-0.1389	0.889658
Lower House[38]	-3410.35	7434.19	-0.4587	0.646952
Upper House[39]	7393.01	10510.35	0.7034	0.482675
Tensys[40]	323.58	366.11	0.8838	0.377914
Checks[41]	945.04	647.90	1.4586	0.146337
Stabs[42]	-3798.14	3753.61	-1.0119	0.312904

(Table 5) Fixed Effects: Entity-specific Intercepts

<table>
<tr><td>Coefficients:</td><td></td><td></td><td></td><td></td></tr>
<tr><td></td><td>Estimate</td><td>Std. Error</td><td>t-value</td><td>Pr(>|t|)</td></tr>
<tr><td>Voice and Accountability</td><td>58104.68</td><td>20656.95</td><td>2.8128</td><td>0.005432**</td></tr>
<tr><td>Government Effectiveness</td><td>-28314.60</td><td>13468.14</td><td>-2.1023</td><td>0.036855*</td></tr>
</table>

[37] Is there a constitutional limit on the number of years the executive can serve before new elections must be called?
[38] Plurality or proportional representation in the lower house?
[39] Plurality or proportional representation in the upper house?
[40] How long has the country been autocratic or democratic, respectively?
[41] Do both the executive branch and the legislature wield checks to each other, or not?
[42] The percentage of veto players who drop from the government in any given year.

Regulatory Quality	19645.55	23833.15	0.8243	0.410816
Rule of Law	6716.96	23760.12	0.2827	0.777719
Control of Corruption	27868.82	14703.86	1.8953	0.059582.
Finite Term[43]	-1526.41	10987.28	-0.1389	0.889658
Lower House[44]	-3410.35	7434.19	-0.4587	0.646952
Upper House[45]	7393.01	10510.35	0.7034	0.482675
Tensys[46]	323.58	366.11	0.8838	0.377914
Checks[47]	945.04	647.90	1.4586	0.146337
Stabs[48]	-3798.14	3753.61	-1.0119	0.312904
F-statistic: 2.26217 on 11 and 188 DF, p-value: 0.013076				

(Table 6) Fixed Effects for Countries

Algeria	Australia	Belgium	Bhutan
-41857.46	-67270.96	-49367.29	-37729.77
Bolivia	Brazil	Burundi	Czech Republic
-44819.21	-33766.44	-41470.17	-74464.77

[43] Is there a constitutional limit on the number of years the executive can serve before new elections must be called?
[44] Plurality or proportional representation in the lower house?
[45] Plurality or proportional representation in the upper house?
[46] How long has the country been autocratic or democratic, respectively?
[47] Do both the executive branch and the legislature wield checks to each other, or not?
[48] The percentage of veto players who drop from the government in any given year.

Dominican Rep.	Dem Rep. Congo	Germany	Haiti
-34777.87	-17443.33	-14720.38	-48160.05
India	Italy	Japan	Kazakhstan
-63647.33	-43687.59	-43156.01	6539046.55
Liberia	Madagascar	Mexico	Nigeria
-38213.56	-60598.95	-30608.26	-27653.66
Paraguay	Philippines	Poland	Romania
-86314.10	-29371.28	-49067.03	-40878.05
Rwanda	Spain	Switzerland	Venezuela
-72259.67	-46862.33	-54596.75	-22082.33
Zimbabwe			
-75950.54			

(Table 7) F Test for Individual Effects

Data: MNA ~ system+finittrm+housesys+sensys+tensys+checks+ …
F=4.2549, df1=27, df2=188, **p-value=1.496e-09**
Alternative hypothesis significant effects

(Table 8) Democracy

Coefficients:				
	Estimate	Std. Error	t-value	Pr(>|t|)
Democracy (Fixed)	1298.46	440.46	2.948	0.003243**
Democracy (Random)	1466.665	433.051	3.3868	0.0007227***

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