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Article — Published Version

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British Journal of Management

Provided in Cooperation with:

John Wiley & Sons

Suggested Citation: Ahmad, Muhammad Farooq; Aktas, Nihat; Aziz, Saqib (2022) : Does Bilateral Trust Matter During Mergers and Acquisitions Negotiations?, British Journal of Management, ISSN 1467-8551, Wiley, Hoboken, NJ, Vol. 34, Iss. 4, pp. 2212-2233, <https://doi.org/10.1111/1467-8551.12692>

This Version is available at:

<https://hdl.handle.net/10419/288054>

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Does Bilateral Trust Matter During Mergers and Acquisitions Negotiations?

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We examine the effect of bilateral trust on cross-border mergers and acquisitions (M&As). Using a large European M&A sample, we find that bilateral trust facilitates deal announcement and completion. Bidder and target bilateral trusts towards each other are both important for deal announcement, but only bidder trust towards the target firm matters for deal completion. The effect of bilateral trust on deal completion is amplified in more complex transactions and when bidders face severe liability of foreignness. Moreover, bilateral trust between the parties is also associated positively with merger performance. These results support the importance of bilateral trust as a deal facilitator in negotiation settings characterized by contract incompleteness and liability of foreignness.

Introduction

Mergers and acquisitions (M&As) are major corporate events, shaping firm boundaries and requiring important managerial attention and involvement. The M&A process is complex (Cartwright and Schoenberg, 2006), and its implementation from private initiation until closing takes time. It is also associated with uncertainties for the involved companies and entails challenging negotiation rounds between the parties (for a detailed description of the takeover process, see e.g. Boone and Mulherin, 2007; Welch *et al.*, 2020; Aktas *et al.*, 2021).

An important consequence of this complexity is that not all initiated takeover processes lead to a takeover agreement, and not all announced agreements are completed. The prior literature indicates that a typical bidder fails to close 29% of the processes that have entered the negotiation/due diligence phase (Aktas *et al.*, 2021), and the proportion of agreed and publicly announced transactions that fail to close is between 8% and 15% (see e.g. Bereskin *et al.*, 2018; Jacobsen, 2014; Officer, 2003). The failure to close an M&A deal

may have major consequences: it may damage the reputation of the unsuccessful bidder (Luo, 2005) and negatively affect its stock price (Jacobsen, 2014; Savor and Lu, 2009). It is therefore important for bidders not only to anticipate potential deal breakers, but also to identify factors favouring deal announcement and completion.

This paper focuses on one important factor that has so far received scant attention, namely the role of bilateral trust between the parties in an M&A negotiation. Adopting a rational economic perspective (i.e. the firm value maximization principle), we hypothesize that bilateral trust between the parties is expected to favour better communication and information sharing, thereby mitigating uncertainties and risks associated with deal completion. We focus on cross-border deals because, in comparison with domestic deals, they are associated with more uncertainties for the involved companies owing to the liability of foreignness (Shimizu *et al.*, 2004; Zaheer, 1995). In an important departure from prior literature focusing on cultural factors explaining M&As (see e.g. Ahern, Daminelli and Fracassi, 2015; Ahmad, Aziz and Dowling, 2022; Dikova, Sahib and van

Witteloostuijn, 2010; Popli et al., 2010; Teerikanigas and Very, 2006), we adopt a dyadic approach that gives equal emphasis to both parties in a negotiation (that is, the bidder and the target firm), and assess whether bilateral trust between bidders and targets facilitates deal announcement and completion. To better gauge the importance of bilateral trust in merger negotiations, we further assess settings in which bilateral trust is likely to be more valuable to deal completion.

Relying on a large sample of European cross-border M&A deals, we provide new evidence about the effect of bilateral trust in M&A negotiations. To account for the conceptual distinction between trust (or trusting) and trustworthiness (or being trustworthy) emphasized in Glaeser *et al.* (2000), we adopt a dyadic approach and distinguish between the trust of the bidder towards the target firm (i.e. trust or trusting) and the trust of the target firm towards the bidder (i.e. trustworthiness or being trustworthy). Empirically, we measure trust at the country-pair level following the approach developed in Guiso, Sapienza and Zingales (2009) with Eurobarometer data and recently used by Bottazzi, Da Rin and Hellmann (2016) and Pursiainen (2022) in the context of venture capital investments and equity analyst recommendations, respectively.

Our M&A sample includes the countries covered by the Eurobarometer survey and contains all announced cross-border deals between them during the period 1990–2018, totalling an aggregate deal value of \$US 2,103.57 billion. We start the empirical examination with the deal announcement analysis at the country-pair level. Estimating first separate models with trust (i.e. the perceived trust of the bidder towards the target firm) and trustworthiness (i.e. the perceived trust of the target firm towards the bidder), our results indicate that both trust variables positively and significantly affect M&A activity between the corresponding country pair. In terms of economic significance, we find that a one standard deviation increase in trust or trustworthiness raises the M&A intensity by about 2 percentage points. These are substantial economic effects, given that the average M&A intensity is 12% in our sample. We uncover a similar pattern with country-pair M&A volume as a dependent variable. We then include both trust and trustworthiness in the same specification. The results indicate that both trust and trustworthiness continue to matter for deal

announcement at the country-pair level, even after controlling for the bilateral trust of the other party.

Next, we turn our analysis to the deal level and examine the effect of bilateral trust on deal completion. When included independently in the specification, both trust and trustworthiness matter for deal completion. In the full model, however, only the trust of the bidder towards the target is statistically significant. In terms of economic effect, a one standard deviation increase in bilateral trust is associated with a 2 percentage points increase in deal completion. Relative to the mean completion rate of 89% in our sample, this economic effect translates into a 2.24% increase in the completion rate.

Taken collectively, our results resonate with the findings documented in the qualitative study of Graebner (2009). She focuses on the acquisition of entrepreneurial firms and emphasizes that sellers are more disciplined in selecting trustful partners during the initiation phase, while bidders appear not to eliminate all distrusted partners at the early stage. Our results are consistent with these observations, as we also document an asymmetry in the importance of bilateral trust for deal completion. We also emphasize that our specifications systematically control for cultural determinants identified in prior M&A literature (such as cultural distance, same language, same colony, shared border, and geographical distance), and therefore the independent trust effect that we document goes beyond these cultural values.

To further support that trust really matters in cross-border M&A negotiations, we implement several cross-sectional tests and examine settings in which trust is likely to be more valuable to the M&A negotiation process. Relying on a rich set of proxies borrowed from the prior literature, we confirm that the positive effect of trust on deal completion is amplified in complex deals and when bidders face severe liability of foreignness.

We also conduct various robustness tests to ensure that our findings are not affected by potential endogeneity issues related to reverse causality and omitted variable biases. We first emphasize that reverse causality is less likely to be an issue in our setting. As emphasized in Bottazzi, Da Rin and Hellmann (2016), the use of country-level measure as a proxy for bilateral trust allows us to dismiss reverse causality in the firm-level analysis.¹ Concerning

¹Trust between the countries may affect the bidder's decision whether or not to close the corresponding

the deal announcement analysis at the country-pair level, reverse causality is also less likely to be an issue. This is because, with the Eurobarometer surveys ending in 1996, we have by construction an important lag structure between the considered M&A outcomes and independent variables of interest. To mitigate omitted variable bias, our baseline specifications systematically control for a rich set of regressors (i.e. deal, country, and country-pair characteristics) and fixed effects. To further assess the robustness of our findings, we also replicate our baseline test with an instrumental variable approach, a propensity-score-matching approach, and subsample analyses. Our main findings persist throughout these additional robustness checks.

Some of our results could also be consistent with the behavioural aspect of trust (i.e. trust favouring deal making, even in the absence of a valid economic rationale motivating the deal). To disentangle the rational economic perspective from the behavioural aspect of trust, we examine the effect of bilateral trust on merger performance, considering both announcement abnormal return and industry-adjusted return on assets (ROA) as performance metrics. We uncover a positive effect of trust on merger performance. Collectively, our results are more in line with the adopted rational economic perspective than with the behavioural aspect of trust.

In terms of its contribution, our paper first relates to the research stream examining the drivers of cross-border M&A transactions in general (e.g. Dong and Doukas, 2022; Erel, Liao and Weisbach, 2012; Rossi and Volpin, 2004), and it adds to the growing literature examining the effect of cultural factors on M&As in particular (e.g. Ahern, Daminelli and Fracassi, 2015; Ahmad, Aziz and Dowling, 2022; Bereskin *et al.*, 2018; Boone and Uysal, 2020; Dikova, Sahib and van Witteloostuijn, 2010; Graebner, 2009; Lin and Pursiainen, 2019; Popli *et al.*, 2010; Teerikangas and Vero, 2006). In an international context, for instance, Ahern, Daminelli and Fracassi (2015) show that differences in cultural values between countries deter cross-border M&A activity, while Dikova, Sahib and van Witteloostuijn (2010) emphasize the negative impact of institutional differences on deal completion. In a domestic context, cultural simi-

ilarity between firms also favours deal announcement and completion (Bereskin *et al.*, 2018; Lin and Pursiainen, 2019).² Based on a qualitative multiple-case study of 12 entrepreneurial firms and eight acquirers, Graebner (2009) explores the role of trust and trustworthiness between the top management teams of the buyer and seller in the acquisition of entrepreneurial firms. We focus on the bilateral trust between the bidder and the target, relying on a country-pair level measure as a proxy for the trust at the firm level. Our results echo the findings in Graebner (2009) and emphasize the importance of bilateral trust during M&A negotiations. We further explore boundary conditions of the relationship between bilateral trust and deal completion and examine its effect on merger performance.

Finally, our paper complements the literature that has relied on Eurobarometer data to measure trust. Guiso, Sapienza and Zingales (2009) are the first to use a trust measure, developed from Eurobarometer surveys. After examining its determinants and external validity, they assessed its effect on bilateral trade between countries. Other important contributions have followed, examining the effect of trust in various contexts: decentralization decisions in multinational firms (Bloom, Sadun and Reenen, 2012), protectionism in M&A regulation (Dinc and Erel, 2013), venture capital investment (Bottazzi, Da Rin and Hellmann, 2016), and analyst recommendations (Pursiainen, 2022). To our knowledge, the paper by Bottazzi, Da Rin and Hellmann (2016) is the closest to what we do, but the authors look at venture capital (VC) investment, not at the M&A process. Hain, Johan and Wang (2016) also examine the effect of trust in a VC investment context, but they do not use bilateral trust measures as in Bottazzi, Da Rin and Hellmann (2016), but focus instead on relational and institutional trust measures using the World Values Survey. In this study, we focus on different corporate outcomes, combining macro- and micro-level analyses to show that bilateral trust is valuable in cross-border M&A negotiations and that it has an independent effect that goes beyond the cultural factors identified in the prior literature.

cross-border deal, but the likelihood of completing a given M&A transaction is less or not likely to influence the trust between countries.

²Bereskin *et al.* (2018) use firms' corporate social responsibility characteristics to proxy for cultural similarity, while Lin and Pursiainen (2019) rely on a county-level measure of cultural trust based on the World Values Survey data.

Theoretical background and the development of hypotheses

There is a rich literature that underlines the importance of trust for economic exchanges (see e.g. Guiso, Sapienza and Zingales 2006 for a review). Trust is usually defined as the ability of an economic agent to rely on others in the context of an economic exchange associated with risk and vulnerability (Graebner, 2009). As emphasized by Carlin, Dorobantu and Viswanathan (2009), trust may find its root in law or culture (i.e. generalized trust) and/or develop with repeated interactions (i.e. personalized trust). We focus mainly on generalized trust in the country-dyadic setting, as in Bottazzi, Da Rin and Hellmann (2016) and Pursiainen (2022), because we are interested in the effect of trust in the early stages of the M&A process, when the parties most likely lack the repetitive interactions needed to develop personalized trust.

In an economy where information would be perfect and transaction cost inexistent, the ability to write contracts that are protective to an economic agent (i.e. complete contracts) renders trust less (or not) important to the relationship between contracting parties (Williamson, 1993). In real-life settings, however, contracts regulating inter-organizational interactions are most often incomplete (Maskin and Tirole, 1999). Therefore, in addition to formal structures, organizations also need to rely on informal ones, such as norms and trust, to mitigate risk and uncertainty in their interactions (see e.g. Arrow, 1974; Jones, 1995; Kramer and Tyler, 1996; Malhotra and Murnighan, 2002), and to maximize their value. This is what we denote as the rational economic perspective.

The context of cross-border M&As is particularly relevant to an examination of the effect of bilateral trust between the negotiation parties, because in comparison to domestic transactions, cross-border deals are associated with more uncertainties for the involved companies owing to the liability of foreignness. We adapt the definition of liability of foreignness in Zaheer (1995) to the M&A context and define it as ‘all of the additional costs that a bidder incurs in a cross-border deal compared with a similar domestic transaction’. It is also important to emphasize that, despite an increase in the sophistication of M&A contracts over time, it remains almost impossible to contract on all verifiable contingencies and avoid ex-post disputes (Coates, 2016a, 2016b). Under the rational

economic perspective, bilateral trust is expected to favour better communication and information sharing between the parties, mitigating the uncertainties and risks associated with deal making. We therefore predict that bilateral trust between the parties will correlate positively with cross-border M&A announcements (Hypothesis 1).

The next stage of the M&A process that we consider is the post-signing phase, which leads to the completion of the deal (also referred to as the legalization or the public phase). Graebner (2009) argues that sellers are more selective at initiation, and therefore their trust towards the bidder might not matter for deal completion, mainly because of the shift of power from the seller to the buyer after the acquisition. From the bidder's perspective, there is no specific reason to restrict the process to only trustful partners at the initiation. The due diligence tasks after initiation certainly allow any potential deal risk to be uncovered (Lajoux and Elson, 2000). Moreover, the completion of cross-border deals adds an additional challenge to the bidder because of two major procedural hurdles, as emphasized in Dikova, Sahib and van Witteloostuijn (2010). The first hurdle is compliance with the antitrust policy of several jurisdictions, and the second one relates to the implementation of internal announcement strategies to inform various stakeholders about the merger proposal. Factors favouring better communication and information sharing between the parties are therefore key for the improvement of the overall due diligence and attenuation of the challenges during the post-signing phase. We therefore hypothesize that only the bidder's trust towards the target is expected to matter for deal completion (Hypothesis 2).

In order to better isolate the effect of bilateral trust on deal closing, we also consider boundary conditions. The prior literature suggests that generalized trust is relatively more valuable in the presence of incomplete contracts and weak regulation (see e.g. Aghion *et al.*, 2010; Carlin, Dorobantu and Viswanathan, 2009; Zak and Knack, 2001). We account for contract incompleteness with the complexity dimension of the deal. The trust effect is also likely to be amplified in settings characterized by severe liability of foreignness, such as, for example, when the bidder and the target are distant in terms of institution and legal system, or when the bidder lacks cross-border M&A experience (see e.g. Dikova, Sahib and van Witteloostuijn, 2010; Hain, Johan and Wang, 2016; Popli *et al.*, 2010).

We therefore hypothesize that the positive effect of the bidder's trust towards the target on deal completion is expected to be amplified both in complex deals and when bidders face severe liability of foreignness (Hypothesis 3).

Data and sample description

Sample

We start with all European countries covered by the Eurostat's Eurobarometer survey. We extract from the Thomson Financial Securities Data Corporation (SDC) Mergers and Acquisitions database all announced cross-border deals between these countries over the period 1990–2018. Our sample includes completed and withdrawn M&A transactions, as well as transactions pending for more than 2 years.³ We drop M&A transactions for which the status of the bidder and target firms is government, joint ventures, and mutual funds, and for which the acquisition form is buyback, exchange offer, recapitalization, and acquisition of partial interest. Our data filters yield a sample of 21,468 announced cross-border deals, totalling an aggregate value of \$2,103 billion, out of which 2,291 deals, corresponding to an aggregate value of \$439 billion, were not completed. In number and dollar value, the proportion of non-completed M&A deals is 10.67% and 20.91%, respectively. Table 1 reports the distribution of the number and dollar value of all announced deals in our sample and for the subsample of completed deals across the years (Panel A) and the countries (Panel B). The sample distribution is largely consistent with the prior literature (Ahmad, de Bodt and Harford, 2021).

Measuring bilateral trust

To examine whether trust matters in M&A negotiations, we rely on a country-pair-level measure developed in Guiso, Sapienza and Zingales (2009) with Eurostat's Eurobarometer survey. This bilateral trust proxy has been widely used in the prior literature to examine its effect on both macroeconomic and microeconomic outcomes (Dinc and

Erel, 2013; Bloom, Sadun and Reenen, 2012; Bottazzi, Da Rin and Hellmann, 2016; Guiso, Sapienza and Zingales, 2009; Pursiainen, 2022). The measure is based on the following Eurobarometer survey question: 'I would like to ask you a question about how much trust you have in people from various countries. For each, please tell me whether you have a lot of trust, some trust, not very much trust or no trust at all.' The answers range from 1 (no trust at all) to 4 (a lot of trust). Following the same approach as in Pursiainen (2022), the bilateral trust measure is derived from the Eurobarometer survey waves from 1970 to 1996 and corresponds to the percentage of individuals saying that they have a lot of trust towards the destination country (i.e. who respond 4 to the survey question).

The considered bilateral trust measure is time-invariant over our sample period. We therefore implicitly assume a degree of cross-sectional stability in bilateral trust that can be captured with a time-invariant measure. This is not a major issue, as cultural traits and attitudes are known to be very stable over time (Guiso, Sapienza and Zingales, 2009). Note that to alleviate the concern about the lack of time-series variations in bilateral trust, we also rely on moderating factors to offer a better identification of the trust effect on M&As.

We define the bilateral trust measure in the online Appendix A and report the corresponding scores for each country pair in the online Appendix B. The bilateral trust variable ranges between 0.04 (trust from the Netherlands towards Italians) and 0.73 (trust of citizens in Finland for their countrymen). There is also a strong correlation between trust (i.e. trusting) and trustworthiness (i.e. being trusted). For example, Austrians trust Germans relatively more in comparison to other countries (with a trust score of 0.36), and the same is true for Germans trusting Austrians (with a trust score of 0.32).⁴ The average of both trust and trustworthiness also displays cross-sectional variation, indicating that some countries are fundamentally more trustworthy than others (e.g. Denmark and Norway), while other countries

³We keep transactions that are pending for more than 2 years in our sample, as is common in the prior literature (see, e.g., Zhou, Xie, and Wang, 2016). Note, however, that removing all pending transactions from our main sample does not affect our main results (unreported).

⁴Trust and trustworthiness are expected to be strongly correlated (Glaeser et al., 2000; Guiso, Sapienza, and Zingales, 2009), and this is also the case in our sample. The Pearson correlation between trust and trustworthiness is 0.676 in our sample, and statistically significant at the 1% level (unreported in a table).

Table 1. M&A sample

Panel A. Distribution by year						
Year	Number of deals			Deal value (in \$ billions)		
	All deals	Completed deals	Proportion completed	All deals	Completed deals	Proportion completed
1990	350	336	96.00%	16.00	10.58	66.13%
1991	448	433	96.65%	12.99	9.20	70.82%
1992	366	343	93.72%	13.47	12.98	96.36%
1993	368	348	94.57%	14.18	12.45	87.80%
1994	398	388	97.49%	10.81	10.81	100.00%
1995	511	503	98.43%	15.45	12.58	81.42%
1996	528	464	87.88%	12.26	11.49	93.72%
1997	609	563	92.45%	28.44	27.70	97.40%
1998	819	746	91.09%	99.22	76.92	77.52%
1999	1,084	984	90.77%	425.67	323.23	75.93%
2000	1,439	1,266	87.98%	141.31	131.56	93.10%
2001	993	858	86.40%	43.96	38.88	88.44%
2002	676	591	87.43%	24.60	23.24	94.47%
2003	625	551	88.16%	16.26	15.84	97.42%
2004	642	543	84.58%	96.67	93.84	97.07%
2005	837	771	92.11%	86.42	81.72	94.56%
2006	931	835	89.69%	90.75	60.79	66.99%
2007	1,201	1,074	89.43%	94.46	79.39	84.05%
2008	947	859	90.71%	86.41	37.80	43.74%
2009	555	497	89.55%	13.22	12.68	95.92%
2010	682	616	90.32%	50.09	47.03	93.89%
2011	718	634	88.30%	47.17	38.00	80.56%
2012	695	636	91.51%	32.03	28.01	87.45%
2013	614	540	87.95%	24.13	22.89	94.86%
2014	707	613	86.70%	50.74	34.12	67.24%
2015	820	705	85.98%	245.35	240.20	97.90%
2016	899	787	87.54%	63.41	54.49	85.93%
2017	978	826	84.46%	96.54	35.70	36.98%
2018	1,028	867	84.34%	151.57	79.54	52.48%
Total	21,468	19,177	89.33%	2,103.57	1,663.66	79.09%

Panel B. Distribution by country						
Bidder nation	Number of deals			Deal value (in \$ billions)		
	All deals	Completed deals	Proportion completed	All deals	Completed deals	Proportion completed
Austria	637	549	86.19%	7.81	7.32	93.73%
Belgium	1,142	1,019	89.23%	141.42	135.21	95.61%
Denmark	1,069	968	90.55%	41.28	34.71	84.08%
Finland	939	831	88.50%	52.18	50.93	97.60%
France	2,897	2,580	89.06%	342.41	248.28	72.51%
Germany	2,803	2497	89.08%	352.89	194.8	55.20%
Greece	80	72	90.00%	6.14	6.06	98.70%
Ireland	927	860	92.77%	39.53	36.17	91.50%
Italy	870	792	91.03%	65.25	42.37	64.93%
Netherlands	2,230	1,979	88.74%	339.92	264.03	77.67%
Norway	456	395	86.62%	27.52	25.18	91.50%
Portugal	111	101	90.99%	1.07	1.06	99.07%
Spain	657	612	93.15%	92.45	65.87	71.25%
Sweden	2,678	2,263	84.50%	89.32	76.85	86.04%
UK	3,972	3,659	92.12%	504.37	474.83	94.14%
Total	21,468	19,177	89.33%	2,103.57	1,663.66	79.09%

Note: This table presents the yearly distribution of the cross-border M&A sample in Panel A and by bidder country in Panel B. The first three columns report on the number of deals, and the last three columns on the aggregate deal value (in US\$ billions). All deals

Table 1. (Continued)

include all announced transactions in our sample (i.e. completed, withdrawn, and pending for more than two years). M&A data are from the Thomson Reuters SDC database.

are more inclined to generally trust people more than others (e.g. Sweden, and Finland). To remove these systematic differences in trust and trustworthiness, our empirical specifications include bidder and target country fixed effects. This approach allows us to isolate the component of bilateral trust that cannot be explained by time-invariant bidder and target country characteristics (such as e.g. culture, ethnicity, and institutional system).

Empirical strategy

This paper examines the effect of bilateral trust on M&A deal announcement and completion, focusing on the legalization phase of the M&A process, which corresponds to ‘the period between signing an agreement in principle and officially closing the deal’ (Graebner, 2009 pp. 458). The negotiation phase that leads to the signing of an M&A agreement takes places mostly privately (see e.g. Aktas *et al.*, 2021; Boone and Mulherin, 2007; Masulis and Simsir, 2018), which makes the examination of the drivers of deal initiation at the firm level on a large scale in the European context challenging.^{5,6} To overcome this limitation, we implement a country-pair-level analysis of deal announcement. We consider two dependent variables: (i) the M&A intensity, defined as the share of the target country in the cross-border activity of the bidder country in year *t*;

⁵There are studies that examine deal initiation in an M&A context relying on a qualitative approach and offering survey-based evidence on relatively small samples (see, e.g., Graebner, 2009; Aktas *et al.*, 2021).

⁶In the United States, firms disclose the details of their M&A agreements to investors via filings to the Securities Exchange Commission (SEC). Following Boone and Mulherin (2007), researchers collect information about the private phase of the M&A process using the background section of the corresponding SEC filings; such a disclosure of the private phase of the M&A process does not exist in Europe. For example, Masulis and Simsir (2018) use SEC filings to understand the drivers of the target initiation.

and (ii) the M&A volume, which corresponds to the logarithm of the number of announced deals between the corresponding country pair in year *t*.

In the second step, we examine the effect of bilateral trust on deal completion at the firm level, using the completion dummy as a dependent variable. The completion dummy takes the value of 1 if the corresponding deal is completed, and 0 otherwise.⁷ In both our deal announcement and completion models, we control for a large set of time-varying country and country-pair characteristics, and a dense set of fixed effects. In addition, we also control for deal characteristics in the completion analysis. For a better flow of the discussion, the estimated models are introduced in the results section.

Given that the bilateral trust proxy is a time-invariant country-pair variable, an important aspect of our empirical strategy consists in identifying contexts in which trust is likely to play a more important role in M&A negotiations. To this end, with the help of moderating factors, we implement cross-sectional tests aimed at comparing settings in which trust is relatively more valuable for deal completion, such as contract incompleteness and the severity of liability of foreignness.

The complexity of the deal likely relates to contract incompleteness. The first complexity proxy that we consider is the merger dummy. Mergers, in comparison with other acquisition methods, such as tender offers, take more time to be implemented, as they require shareholder voting and the creation of a new legal entity (Offenberg and Pirinsky, 2015). The form of payment also influences the complexity of the deal. Payment considerations including the bidder’s stock are relatively more complex than cash transactions in terms of valuation (Servaes and Zenner, 1996; Kisgen, Qian and Song, 2009). Larger transactions are also considered as being relatively more complex, as they are more likely to attract public scrutiny from regulators and institutional investors (Aktas, de Bodt and Roll, 2007; Kisgen, Qian and Song, 2009). Finally, because R&D-intensive companies are known to be relatively more difficult to value,

⁷For the subsample of completed transactions, we also repeat our baseline analysis, with the time to completion as a dependent variable, relying both on linear and on non-linear models. These results are available in the online Appendix D.

Table 2. Summary statistics

Variable name	Mean	St. dev.	Q1	Median	Q3	N
<i>Dependent variables</i>						
M&A intensity – country pair	0.117	0.113	0.035	0.078	0.156	3,484
M&A volume – country pair	1.603	0.810	0.693	1.386	2.197	3,484
Completion dummy – deal level	0.893	0.309	1.000	1.000	1.000	21,468
CAR(–3, +3)	0.013	0.073	–0.024	0.004	0.042	2,284
Industry-adjusted ROA (%)	–0.968	7.715	–2.750	0.000	3.030	92,516
<i>Independent variables of interest</i>						
Bilateral trust	0.240	0.153	0.139	0.184	0.295	21,468
<i>Deal characteristics</i>						
Private target	0.563	0.496	0.000	1.000	1.000	21,468
Cash only	0.129	0.336	0.000	0.000	0.000	21,468
Diversifying deal	0.425	0.494	0.000	0.000	1.000	21,468
Financial bidder	0.100	0.300	0.000	0.000	0.000	21,468
Toehold (%)	0.478	4.170	0.000	0.000	0.000	21,468
<i>Country characteristics</i>						
Bidder GDP	27.677	0.962	26.784	28.019	28.564	21,468
Bidder openness	0.809	0.355	0.549	0.693	0.894	21,468
Bidder GDP growth	0.023	0.023	0.013	0.023	0.034	21,468
Bidder investment profile	10.104	1.999	8.833	11.000	12.000	21,468
Target GDP	27.732	0.953	26.795	28.120	28.567	21,468
Target openness	0.773	0.332	0.540	0.662	0.865	21,468
Target GDP growth	0.021	0.021	0.013	0.022	0.032	21,468
Target investment profile	10.057	2.003	8.750	11.000	11.792	21,468
<i>Country-pair characteristics</i>						
Difference in GDP	1.059	0.802	0.329	0.778	1.736	21,468
Difference in GDP growth	0.015	0.018	0.005	0.011	0.019	21,468
Difference in openness	0.337	0.345	0.071	0.212	0.573	21,468
Difference in investment profile	0.879	0.939	0.125	0.500	1.333	21,468
Geographical distance	6.551	0.589	6.072	6.708	7.027	21,468
Cultural distance	1.273	0.593	0.770	1.188	1.786	21,468
Same language	0.105	0.307	0.000	0.000	0.000	21,468
Same colony	0.086	0.280	0.000	0.000	0.000	21,468
Shared border	0.028	0.164	0.000	0.000	0.000	21,468
<i>Moderating variables</i>						
Merger dummy	0.176	0.381	0.000	0.000	0.000	21,468
Stock dummy	0.020	0.123	0.000	0.000	0.000	21,468
Deal size (US\$ billion)	0.354	3.948	0.005	0.018	0.077	5,500
Innovative target dummy	0.155	0.362	0.000	0.000	0.000	21,468
No experience target country	0.893	0.309	1.000	1.000	1.000	21,468
Distance institutional quality	0.202	2.009	–1.000	0.000	1.417	21,468
Distance expropriation risk	–0.039	1.281	–0.583	0.000	0.500	21,468
Different legal origin	0.618	0.486	0.000	1.000	1.000	21,468

Note: This table provides descriptive statistics of dependent variables, independent variables of interest, deal characteristics, country characteristics, and time-variant country-pair characteristics from 15 European countries for the period 1990–2018. Definitions of the variables are in online Appendix A. Q1 and Q3 denote the first and the third quartile, respectively, and N is the number of observations.

we use the innovative target dummy, which identifies targets from R&D-intensive industries, as an additional complexity proxy (Ahmad, de Bodt and Harford, 2022).

To capture the severity of the liability of foreignness faced by the bidder, we follow the prior literature and consider four alternative proxies: (i) distance in terms of institutional quality; (ii) distance in terms of expropriation risk; (iii) dif-

ference in terms of legal origin; and (iv) the lack of M&A experience in the target country (see e.g. Ahern, Daminelli and Fracassi, 2015; Col and Errunza, 2015; Dikova, Sahib and van Witteloostuijn, 2010; Hain, Johan and Wang, 2016; La Porta *et al.*, 1998). Summary statistics on the dependent and independent variables employed in the empirical analyses are reported in Table 2, while detailed variable definitions and the correlation

matrix are provided in online Appendix A and C, respectively.

The effect of bilateral trust on deal announcement and completion

Bilateral trust and deal announcement

To examine the relation between bilateral trust and M&A deal announcement, we adopt the following econometric specification:

$$\begin{aligned} \text{Trust } B \rightarrow T_{ij} + \beta_2 \text{ Trust } T \rightarrow B_{ij} \\ + \beta_3 \text{ Country variables} \\ + \beta_4 \text{ Country} - \text{pair variables} \\ + \text{YearFE} + \text{CountryFE} + \varepsilon_{i,j,t} \end{aligned} \quad (1)$$

where $MA_{ij,t}$ is either the M&A intensity (i.e. the share of the target country in the cross-border activity of the bidder country) or the M&A volume (i.e. the logarithm of the number of deals between country i and j) at the country-pair level in year t ; i denotes the bidder country and j the target country; and $\text{Trust } B \rightarrow T$ (respectively $B \rightarrow T$) is the bilateral trust of the bidder (respectively, target firm) towards the target firm (respectively, bidder). When the two trust variables are included in the same specification, we first orthogonalize the variables because of the existence of a strong correlation.⁸ Following the extant literature, the baseline specification further includes as additional controls time-varying country variables for both the target country and the bidder country, such as GDP, GDP growth, openness (imports and exports divided by GDP), and investment profile (i.e. time-varying index measuring the government's attitude towards investment), as well as their difference between the bidder country and the target country as time-varying country-pair variables. In addition, we control for geographical distance, shared border, and difference in cultural values potentially affecting M&A outcomes [such as the same language, same colony, and cultural distance based on Hofstede's (2001) four culture dimensions]. The baseline specification also includes a dense set of fixed effects (FEs), such as

year dummies to control for changing macro-economic conditions, and country dummies to account for time-invariant country characteristics such as culture, ethnicity, and institutional system. We further augment the baseline model with country \times year FEs as a robustness check, but without including time-varying country-level variables. These interactions absorb all time-varying country characteristics and therefore impose even stricter controls to alleviate omitted variable bias. We cluster standard errors at the bidder–target country-pair level to account for within-country-pair time-series correlation.

We estimate Equation (1) with both tobit and ordinary least squares (OLS) regressions. Despite the two methods yielding similar results, in what follows we discuss mainly the OLS results, for brevity and because the large number of dummy variables in our models could affect tobit estimates (Greene, 2004).⁹ The tobit results are available in the online Appendix D.

Table 3 presents OLS estimates of the effect of bilateral trust on M&A intensity across the 3,484 country-pair-year observations. We first examine the effect of the bidder's trust towards the target firm ($B \rightarrow T$) on deal announcement and report the results in columns 1 and 2. Column 1 reports on the model with time-varying country and country-pair characteristics, and column 2 imposes even stricter controls with the inclusion of country \times year FEs. The coefficient estimate of the trust variable is positive and highly significant at the 1% level, in both columns, with a value of 0.137 and 0.146, respectively. In terms of economic significance, a one standard deviation increase in bilateral trust increases the M&A intensity by a value in the range 2.10%–2.23%, depending on the considered model.¹⁰ This is a substantial economic impact, given that the sample average of M&A intensity is 12%.

We next assess whether the trust of the target firm towards the bidder matters for deal announce-

⁸To orthogonalize the bilateral trust variables, we rely on the modified Gram–Schmidt procedure (Golub and Van Loan, 2013). The considered procedure modifies $\text{Trust } T \rightarrow B$ and forces it be orthogonal to $\text{Trust } B \rightarrow T$.

⁹Moreover, Angrist and Pischke (2009) argue that if we are concerned mainly with marginal effects, with limited dependent variables, there is no clear benefit from using non-linear models. Moreover, non-linear specifications come with more restrictive assumptions.

¹⁰The standard deviation of bilateral trust is 0.153 in our sample. To get the lower (upper) range of the reported economic effect, we multiply this standard deviation by the coefficient estimate of trust in column 1 (2) of Table 3 – Panel A.

Table 3. Bilateral trust and M&A intensity: country-pair level analysis

	(1)	(2)	(3)	(4)	(5)
<i>Bilateral trust variables</i>					
B→T	0.137*** (0.009)	0.146** (0.014)			0.027*** (0.003)
T→B			0.158*** (0.002)	0.157*** (0.008)	0.016*** (0.008)
<i>Country characteristics</i>					
Bidder GDP	0.035 (0.139)		0.035 (0.129)		
Bidder openness	0.045* (0.057)		0.040* (0.085)		
Bidder GDP growth	−0.001 (0.988)		0.008 (0.908)		
Bidder invest. profile	−0.001 (0.413)		−0.002 (0.231)		
Target GDP	0.005 (0.858)		−0.001 (0.962)		
Target openness	0.040* (0.064)		0.041** (0.048)		
Target GDP growth	−0.145** (0.042)		−0.136* (0.056)		
Target invest. profile	0.000 (0.833)		0.000 (0.851)		
<i>Country-pair characteristics</i>					
Diff. in GDP	−0.026 (0.230)	−0.036 (0.184)	−0.03 (0.164)	−0.042 (0.136)	−0.034 (0.210)
Diff. in GDP growth	−0.026** (0.018)	−0.023* (0.064)	−0.026** (0.023)	−0.022* (0.081)	−0.020* (0.098)
Diff. in openness	0.061 (0.399)	−0.002 (0.992)	0.055 (0.457)	−0.036 (0.845)	−0.038 (0.835)
Diff. in invest. profile	−0.001 (0.665)	−0.001 (0.660)	0.000 (0.777)	0.000 (0.874)	0.001 (0.788)
Geographical distance	−0.074*** (0.000)	−0.075*** (0.000)	−0.068*** (0.000)	−0.069*** (0.000)	−0.064*** (0.000)
Cultural distance	−0.118*** (0.001)	−0.117*** (0.005)	−0.112*** (0.002)	−0.111** (0.011)	−0.111*** (0.008)
Same language	0.054 (0.204)	0.054 (0.256)	0.051 (0.212)	0.051 (0.258)	0.043 (0.347)
Same colony	0.082** (0.014)	0.085** (0.023)	0.093*** (0.007)	0.094** (0.013)	0.098*** (0.008)
Shared border	−0.020 (0.722)	−0.015 (0.813)	−0.013 (0.813)	−0.009 (0.879)	0.000 (0.997)
B/T country FE	Yes	No	Yes	No	No
B/T country × Year FE	No	Yes	No	Yes	Yes
Year FE	Yes	No	Yes	No	No
Adjusted R-squared	0.615	0.604	0.614	0.602	0.607
F-statistic	12.26	17.01	9.92	14.87	13.69
Observations	3,484	3,484	3,431	3,431	3,431

Note: This table presents the estimates of OLS models. The dependent variable is M&A intensity, which corresponds to the number of announced M&A deals between the bidder country *i* and the target country *j* in year *t*, scaled by the bidder country *i*'s total cross-border M&A activity in year *t*. The independent variable of interest is Bilateral Trust. B and T denote, respectively, the bidder and the target firm, and the direction of the arrow identifies the origin and destination of trust. In column 5, given that B→T and T→B are strongly correlated, we first orthogonalize the two trust variables before their inclusion into the specification. All variables are defined in online Appendix A. The models control for a rich set of fixed effects (FEs). Standard errors are corrected for heteroscedasticity at the bidder–target country-pair level. The p-value is reported in parentheses below the coefficient estimate. ***, **, and * indicate significance at 1%, 5%, and 10%, respectively.

ment. To do so, we include in a separate model the trust of the target firm ($T \rightarrow B$) and display the results in columns 3 and 4. As expected, the coefficient estimate of our variable of interest is positive and statistically highly significant in both columns. The corresponding economic effect is again substantial. A one standard deviation increase in perceived trustworthiness raises the share of the target country in the cross-border activity of the bidder country by a value of 2.40%. This result is not surprising, given that perceived trust and trustworthiness are expected to be positively correlated (Glaeser *et al.*, 2000; Guiso, Sapienza and Zingales, 2009), which is also the case in our sample.

We now turn to models where both trust and trustworthiness are included in the same specification in order to examine whether the trust of one party still matters when the trust of the other party is controlled for. We first orthogonalize the two strongly correlated variables of interest before including them in the considered specification. The model reported in column 5 indicates that both trust ($B \rightarrow T$) and trustworthiness ($T \rightarrow B$) continue to matter for deal announcement, once the bilateral trust of the other party is controlled for.¹¹

In Table 4, we repeat the same analysis as in Table 3, but relying this time on the M&A volume between country pairs as a dependent variable. The results on the M&A volume parallel to a large extent the results on M&A intensity. The economic effects of both trust and trustworthiness on M&A volume are large and of almost the same magnitude. Based on the coefficient estimates reported in columns 1–4, a one standard deviation change in bilateral trust increases the log of M&A volume by about 0.13. This is a meaningful economic impact, given that the average of the log M&A volume is 1.60 in our sample.

Concerning the control variables, it is worthwhile to emphasize that both geographical and cultural distance are associated negatively with M&A activity at the country-pair level, while having a former colonial relationship (same colony) favours deal making between the countries. These results are to a large extent consistent with the prior literature (see e.g. Ahern, Daminelli and Fracassi, 2015).

¹¹Note that because the standard deviation of the orthogonalized bilateral trust is equal to one by construction, the economic effect of the estimates in column 5 of Table 3 are of similar magnitude in comparison with the ones in columns 1–4.

In the next subsection, we turn to the microeconomic level and examine the effect of bilateral trust on M&A deal completion.

Bilateral trust and deal completion

To measure the effect of bilateral trust on M&A deal completion, we rely on deal-level regressions to estimate the following equation:

$$\begin{aligned} Completion_d = & \beta_1 \text{ Trust } B \rightarrow T_d \\ & + \beta_2 \text{ Trust } T \rightarrow B_d + \beta_3 \text{ Deal characteristics} \\ & + \beta_4 \text{ Country variables} \\ & + \beta_5 \text{ Country – pair variables} + \text{CountryFE} \\ & + \text{Industry} + \text{YearFE} + \varepsilon_d \end{aligned} \quad (2)$$

where Completion is a dummy variable taking the value 1 if the corresponding deal d is completed, and 0 otherwise. In addition to the controls used in Equation (1), we account for deal characteristics (such as private target, cash payment, diversifying deal, financial bidder, and toehold). Variable definitions are given in online Appendix A. Our baseline specification also includes industry \times year FE to account for any time-varying industry characteristics. The adopted industry definition is the 2-digit SIC classification. We also cluster standard errors at the bidder–target country-pair level to account for within-country-pair time-series correlation. To estimate Equation (2), we rely on both OLS and probit models. For the same reason as highlighted above, we report and discuss the OLS estimates below. The probit results are available in online Appendix D.

Table 5 reports the deal completion results. We follow the same structure as in Tables 3 and 4. We first consider bidder and target bilateral trust separately, and report the results in columns 1–4. In the separate models, both trust and trustworthiness matter for deal completion, with coefficient estimates of almost the same magnitude, but with weaker statistical significance for the target firm's trust. We then include the two orthogonalized trust variables in the same specification and report the estimation result in column 5. While both variables load with a positive coefficient estimate, only the trust of the bidder towards the target firm remains statistically significant in the deal completion regression. In terms of economic effect, a one standard deviation increase in the trust of the bidder towards the target firm is associated with a

Table 4. Bilateral trust and M&A volume: country-pair level analysis

	(1)	(2)	(3)	(4)	(5)
<i>Bilateral trust variables</i>					
B→T	0.807** (0.028)	0.962** (0.024)			0.190*** (0.001)
T→B			0.985*** (0.007)	1.083** (0.012)	0.108** (0.011)
<i>Country Characteristics</i>					
Bidder GDP	0.298 (0.114)		0.258 (0.176)		
Bidder openness	0.172 (0.256)		0.199 (0.191)		
Bidder GDP growth	0.649 (0.325)		0.612 (0.358)		
Bidder invest. profile	−0.001 (0.934)		−0.004 (0.703)		
Target GDP	0.185 (0.402)		0.103 (0.649)		
Target openness	0.166 (0.309)		0.289* (0.053)		
Target GDP growth	−0.218 (0.703)		−0.186 (0.742)		
Target invest. profile	−0.001 (0.951)		−0.003 (0.761)		
<i>Country-pair characteristics</i>					
Diff. in GDP	−0.310** (0.040)	−0.385** (0.050)	−0.326** (0.033)	−0.417** (0.042)	−0.361* (0.064)
Diff. in GDP growth	−0.185** (0.020)	−0.194** (0.031)	−0.176** (0.028)	−0.184** (0.043)	−0.170* (0.056)
Diff. in openness	−0.747 (0.166)	−0.177 (0.895)	−0.769 (0.165)	0.023 (0.986)	0.011 (0.993)
Diff. in invest. profile	(0.000) (0.966)	0.001 (0.968)	0.003 (0.785)	0.006 (0.741)	0.007 (0.653)
Geographical distance	−0.539*** (0.000)	−0.549*** (0.000)	−0.526*** (0.000)	−0.537*** (0.000)	−0.495*** (0.000)
Cultural distance	−0.511** (0.024)	−0.540** (0.037)	−0.524** (0.021)	−0.546** (0.036)	−0.545** (0.028)
Same language	0.435*** (0.000)	0.460*** (0.000)	0.408*** (0.000)	0.435*** (0.000)	0.375*** (0.001)
Same colony	0.437*** (0.000)	0.458*** (0.000)	0.457*** (0.000)	0.484*** (0.000)	0.507*** (0.000)
Shared border	−0.310* (0.065)	−0.328* (0.073)	−0.276 (0.110)	−0.297 (0.117)	−0.228 (0.228)
B/T country FE	Yes	No	Yes	No	No
B/T country × Year FE	No	Yes	No	Yes	Yes
Year FE	Yes	No	Yes	No	No
Adjusted R-squared	0.659	0.663	0.662	0.664	0.668
F-statistic	57.69	104.30	51.23	94.13	83.63
Observations	3,484	3,484	3,431	3,431	3,431

Note: This table presents the estimates of OLS models. The dependent variable is M&A volume, which corresponds to the natural logarithm of one plus the total number of cross-border deals between the bidder country *i* and the target country *j* in year *t*. The independent variable of interest is Bilateral Trust. B and T denote, respectively, the bidder and the target firm, and the direction of the arrow identifies the origin and destination of trust. In column 5, given that B→T and T→B are strongly correlated, we first orthogonalize the two trust variables before their inclusion into the specification. All variables are defined in online Appendix A. The models control for a rich set of fixed effects (FEs). Standard errors are corrected for heteroscedasticity at the bidder–target country-pair level. The p-value is reported in parentheses below the coefficient estimate. ***, **, and * indicate significance at 1%, 5%, and 10%, respectively.

Table 5. Bilateral trust and likelihood of deal completion

	(1)	(2)	(3)	(4)	(5)
<i>Bilateral trust variables</i>					
B→T	0.118** (0.017)	0.141*** (0.004)			0.027*** (0.001)
T→B			0.108* (0.097)	0.092 (0.140)	0.009 (0.163)
<i>Deal characteristics</i>					
Private target	0.059*** (0.000)	0.059*** (0.000)	0.059*** (0.000)	0.059*** (0.000)	0.060*** (0.000)
Cash only	0.003 (0.660)	0.007 (0.316)	0.001 (0.917)	0.005 (0.462)	0.006 (0.362)
Diversifying deal	−0.006 (0.234)	−0.006 (0.215)	−0.005 (0.297)	−0.005 (0.275)	−0.006 (0.284)
Financial bidder	0.023*** (0.007)	0.023*** (0.004)	0.021** (0.012)	0.020** (0.012)	0.022*** (0.009)
Toehold	−0.001 (0.140)	−0.001 (0.162)	−0.002 (0.107)	−0.002 (0.101)	−0.001 (0.170)
<i>Country characteristics</i>					
Bidder GDP	−0.005 (0.884)		−0.016 (0.656)		
Bidder openness	0.057 (0.165)		0.057 (0.166)		
Bidder GDP growth	−0.189 (0.348)		−0.202 (0.299)		
Bidder invest. profile	−0.006 (0.127)		−0.004 (0.272)		
Target GDP	−0.115* (0.080)		−0.108* (0.093)		
Target openness	0.017 (0.631)		0.012 (0.758)		
Target GDP growth	0.291 (0.138)		0.258 (0.171)		
Target invest. profile	−0.005* (0.099)		−0.004 (0.223)		
<i>Country-pair characteristics</i>					
Diff. in GDP	0.006 (0.285)	0.006 (0.272)	0.005 (0.351)	0.006 (0.251)	0.006 (0.288)
Diff. in GDP growth	−0.001 (0.976)	−0.002 (0.925)	0.005 (0.789)	0.004 (0.845)	−0.001 (0.964)
Diff. in openness	0.152 (0.419)	0.197 (0.549)	0.106 (0.557)	0.296 (0.369)	0.276 (0.411)
Diff. in invest. profile	0.001 (0.796)	0.000 (0.983)	−0.002 (0.606)	−0.002 (0.610)	0.000 (0.994)
Geographical distance	0.008 (0.193)	0.008 (0.204)	0.005 (0.423)	0.005 (0.478)	0.008 (0.253)
Cultural distance	−0.002 (0.918)	−0.001 (0.952)	−0.006 (0.713)	−0.010 (0.550)	0.002 (0.900)
Same language	0.005 (0.769)	0.006 (0.716)	0.006 (0.738)	0.006 (0.713)	−0.001 (0.970)
Same colony	0.027* (0.087)	0.028* (0.076)	0.016 (0.316)	0.020 (0.212)	0.026 (0.129)
Shared border	−0.013 (0.684)	−0.014 (0.668)	−0.011 (0.737)	−0.007 (0.830)	−0.010 (0.754)
B/T country FE	Yes	No	Yes	No	No
B/T country × Year FE	No	Yes	No	Yes	Yes

Table 5. (Continued)

	(1)	(2)	(3)	(4)	(5)
B/T industry \times Year FE	Yes	Yes	Yes	Yes	Yes
Adjusted R-squared	0.047	0.052	0.045	0.049	0.052
F-statistic	8.64	11.26	8.08	11.31	10.41
Observations	21,468	21,468	21,263	21,263	20,586

Note: This table presents the estimates of linear probability models. The dependent variable takes the value of 1 if the deal is completed, and 0 otherwise. All variables are defined in the online Appendix A. The models control for a rich set of fixed effects (FEs). The adopted industry definition is the 2-digit SIC classification. Standard errors are corrected for heteroscedasticity at the bidder–target country-pair level. The p-value is reported in parentheses below the coefficient estimate. ***, **, and * indicate significance at 1%, 5%, and 10%, respectively.

2% increase in the likelihood of deal completion. These results indicate that the trust of the target firm towards the bidder does not seem to play a role in later stages of the M&A process, echoing the arguments and findings documented in the qualitative study of Graebner (2009).

Concerning the control variables, it is noteworthy that country and country-pair characteristics appear to be less significant in the deal completion analysis. This is likely due to the use of a dense set of FEs (such as country and industry dummies, and their interaction with year dummies).

Endogeneity issues

Although we document a strongly positive bilateral trust effect on deal announcement and completion, the baseline results are potentially subject to endogeneity concerns, such as reverse causality and omitted variable bias.

Reverse causality is, however, less likely to affect our results. As discussed in the Introduction, the use of a country-level proxy for bilateral trust allows us to dismiss reverse causality in the M&A deal completion analysis, which is at the firm level (i.e. the likelihood to complete a given M&A transaction is less or not likely to influence the trust between countries). Concerning the deal announcement analysis at the country-pair level, reverse causality is also less likely to be an issue. This is because, with the Eurobarometer surveys ending in 1996, we have by construction an important lag structure between the considered M&A outcomes and independent variables of interest.

To alleviate the omitted variable bias, our baseline models explicitly control for a rich set of regressors at the deal, country, and country-pair levels, as well as including a dense set of fixed effects depending on the considered model.

To mitigate any remaining endogeneity concerns in our baseline results, we revisit the tests in Tables 3–5 relying on the instrumental variable (IV) approach. Following Guiso, Sapienza and Zingales (2009), we use somatic differences across countries as an instrument for the bilateral trust between the parties in the M&A negotiation (see also Ahern, Daminelli and Fracassi, 2015).¹² Somatic distance, the considered instrument in the first-stage regression, is defined as the sum of the absolute difference between the two countries in each of three traits of the indigenous population: height, hair colour, and cephalic index. We also note that, despite their use in the prior literature, cultural value variables likely directly affect M&A outcomes, and therefore instruments relying on cultural value may violate the exclusion restriction. The results of the IV approach need therefore to be taken with caution.

Table 6 reports the results of the IV approach. The first-stage regression is presented in column 1 for deal announcement, and in column 4 for deal completion. Panel A reports on the bidder's trust towards the target firm as an instrumented variable, and Panel B on the target firm's trust towards the bidder. In the first-stage regressions, somatic distance is negatively and significantly related to bilateral trust. The instrument also passes the relevance test: the F-statistics from the joint test of excluded instruments are between 15 and 37, depending on the considered specifications, and statistically significant at the 1% level.

¹²Guiso, Sapienza, and Zingales (2009) use also genetic differences across countries as an instrument for cultural differences. Repeating our tests with genetic difference as an instrument for bilateral trust yields similar results (unreported). However, because the use of genetic difference reduces our sample size, we have decided to report only the IV approach with somatic difference as an instrument.

Table 6. Instrumental variable approach

Panel A. Bilateral Trust B→T					
	1st stage	2nd stage		1st stage	2nd stage
	B→T (1)	M&A intensity (2)	M&A volume (3)	B→T (4)	Deal completion (5)
Somatic distance	−0.023*** (0.000)			−0.022*** (0.000)	
B→T (instrumented)		0.367*** (0.008)	3.344*** (0.000)		0.277** (0.028)
Deal characteristics	No	No	No	Yes	Yes
Country charact.	Yes	Yes	Yes	Yes	Yes
Country-pair charact.	Yes	Yes	Yes	Yes	Yes
B/T country FE	Yes	Yes	Yes	Yes	Yes
B/T industry × Year FE	No	No	No	Yes	Yes
Year FE	Yes	Yes	Yes	No	No
Overall R-squared		0.294	0.437		0.038
Observations	3,484	3,484	3,484	21,468	21,468
Joint test of excluded instruments	F = 36.85 Prob>F = 0.00			F = 19.39 Prob>F = 0.00	
Panel B. Bilateral trust T→B					
	1st stage T→B (1)	2nd stage M&A intensity (2)	1st stage M&A volume (3)	2nd stage T→B (4)	Deal completion (5)
Somatic distance	−0.021*** (0.000)			−0.020*** (0.000)	
T→B (instrumented)		0.384*** (0.004)	3.618*** (0.001)		0.312** (0.020)
Deal characteristics	No	No	No	Yes	Yes
Country charact.	Yes	Yes	Yes	Yes	Yes
Country-pair charact.	Yes	Yes	Yes	Yes	Yes
B/T country FE	Yes	Yes	Yes	Yes	Yes
B/T industry × Year FE	No	No	No	Yes	Yes
Year FE	Yes	Yes	Yes	No	No
Overall R-squared		0.639	0.624		0.034
Observations	3,431	3,431	3,431	21,263	21,263
Joint test of excluded instruments	F = 29.88 Prob>F = 0.00			F = 15.79 Prob>F = 0.00	

Note: This table replicates columns 1 and 3 of Tables 3–5, using the 2SLS model. Panel A reports on the bidder's bilateral trust towards the target (B→T) as the instrumented variable, and Panel B on the target's bilateral trust towards the bidder (T→B). The first three columns are devoted to the M&A intensity and volume regressions, with column 1 reporting the estimates of the first-stage regression, and columns 2 and 3 the second-stage regressions. The last two columns focus on the deal completion model, with columns 4 and 5 reporting the first-stage and second-stage regressions, respectively. The bilateral trust is instrumented with the somatic distance between bidder and target countries, which is defined as the sum of the absolute difference between the two countries in each of three traits of the indigenous population: height, hair colour, and cephalic index (Source: online appendix of Guiso, Sapienza, and Zingales, 2009). All variables are defined in online Appendix A. The specifications control for a rich set of fixed effects (FEs). The adopted industry definition is the 2-digit SIC classification. Standard errors are corrected for heteroscedasticity at the bidder–target country-pair level. The p-value is reported in parentheses below the coefficient estimate. ***, **, and * indicate significance at 1%, 5%, and 10%, respectively. F denotes the Fisher statistic for the joint test of excluded instruments.

The dependent variables in the second-stage regressions are M&A intensity in column 2, M&A volume in column 3, and deal completion in column 5. Similar to the OLS regressions reported in Tables 3 and 4, we find that both the bidder and the

target firm's trust affect deal announcement positively and significantly at the country-pair level. Concerning the effect of trust on deal completion, the IV and OLS results are similar concerning the effect of bidder's trust, but the marginally

significant target firm's trust effect documented with the OLS approach becomes statistically significant with the IV method.

Having established the robustness of our baseline results, in the next section we examine the boundary conditions of the relationship between trust and deal completion.

Additional results and checks

When does trust matter the most for deal completion?

To further support that trust really matters in cross-border M&A negotiations, we turn to several cross-sectional tests and examine settings in which trust is likely to be more valuable to M&A deals. The two settings in which we expect bilateral trust to matter more are complex deals and when the bidder faces a severe liability of foreignness. The results are reported in Table 7. Panel A reports on complexity, and Panel B on liability of foreignness. For these additional tests, our deal completion specifications include only the trust of the bidder towards the target firm, because the target firm's trust appears to matter less for deal completion, as emphasized in Section 4.2.

We measure the complexity of the transactions based on four deal characteristics: mergers, stock deals, deal size, and innovative target. We augment our baseline model with the corresponding complexity proxy and its interaction term with the bidder's trust towards the target firm. Panel A of Table 7 reports the results. The complexity proxies include the merger dummy (column 1), the stock dummy (column 2), the deal size (column 3), and the innovative target dummy (column 4). In all columns, the coefficient estimate of the interaction term between Trust B→T and Complexity is positive and statistically significant at the 5% level. These results indicate that the bilateral trust of the bidder towards the target is more valuable in complex transactions, helping the bidder to mitigate risks and uncertainties associated with deal closing.

To capture the effect of a severe liability of foreignness on the sensitivity of deal completion to bilateral trust, we rely on country-pair-level proxies in columns 1–3 of Panel B, such as distance in terms of institutional quality and expropriation risk, and difference in terms of legal origin. In column 4, we also consider the bidder's lack

of cultural experience as an additional proxy for the severity of foreignness liability. The considered dummy variable identifies bidders without M&A experience in the target country over a 3-year period prior to the announcement of the focal deal. The coefficient estimate of the interaction term between Trust B→T and Liability of Foreignness is positive and statistically significant at the 5% level in all models. These results indicate that bilateral trust is more valuable for deal completion when the negotiation takes place with a target firm from a country with a relatively weaker institutional quality, relatively higher expropriation risk, and a different legal origin, as well as when the bidder lacks M&A experience in the target country. This latter result is in line with prior studies documenting the importance of learning-by-doing in deal making (Aktas, de Bodt and Roll, 2013; Hayward, 2002; Vermeulen and Barkema, 2001). Collectively, these additional cross-sectional results are consistent with the considered theoretical framework and provide strong support to our hypothesis on the importance of bilateral trust in cross-border M&A negotiations.

Does bilateral trust affect merger performance?

Managers, without proper incentives and monitoring, might be inclined to do deals for behavioural reasons, and bilateral trust could well favour deal making in the presence of behavioural motives. If behavioural motives are at play in our sample, we should observe a negative association between bilateral trust and M&A performance, because M&As implemented by managers pursuing relatively more behavioural rationales are known to be associated with lower acquirer announcement returns (Aktas *et al.*, 2021).

To better disentangle the rational economic channel (i.e. trust mitigating risk and uncertainties) from the behavioural aspect of trust (i.e. trust favouring deal making, even in the absence of a valid economic rationale motivating the deal), we examine the effect of bilateral trust on merger performance, relying on two performance metrics: the acquirer's announcement cumulative abnormal return (CAR) and its industry-adjusted ROA.

Panel A of Table 8 reports the CAR regressions. The dependent variable is the acquirer's CAR computed over a 7-day window centred on the announcement day with the market model and local country index. The specification includes firm

Table 7. Factors moderating the effect of bilateral trust on deal completion

Panel A. Complex deals				
	(1) Merger dummy	(2) Stock dummy	(3) Deal size	(4) Innovative target dummy
B→T	0.017 (0.794)	0.065 (0.234)	0.028 (0.717)	0.067 (0.192)
Complexity	−0.052*** (0.000)	−0.056* (0.064)	−0.021 (0.186)	−0.026* (0.070)
B→T × Complexity	0.084** (0.049)	0.143** (0.041)	0.147** (0.024)	0.143** (0.030)
Deal characteristics	Yes	Yes	Yes	Yes
Country characteristics	Yes	Yes	Yes	Yes
Country-pair charact.	Yes	Yes	Yes	Yes
B/T country FE	Yes	Yes	Yes	Yes
B/T industry × Year FE	Yes	Yes	Yes	Yes
Adjusted R-squared	0.083	0.063	0.032	0.051
F-statistic	8.774	9.916	1.641	10.446
Observations	21,468	21,468	5,427	21,468
Panel B. Liability of foreignness				
	(1) Distance institutional quality	(2) Distance expropriation risk	(3) Different legal origin	(4) No experience target country
B→T	0.062 (0.156)	0.084* (0.075)	0.014 (0.802)	−0.084 (0.338)
Liability of foreignness	−0.009** (0.042)	−0.006 (0.103)	−0.029** (0.032)	−0.005 (0.821)
B→T × Liability of foreignness	0.039** (0.022)	0.025** (0.044)	0.087** (0.031)	0.159** (0.042)
Deal characteristics	Yes	Yes	Yes	Yes
Country characteristics	Yes	Yes	Yes	Yes
Country-pair charact.	Yes	Yes	Yes	Yes
B/T country FE	Yes	Yes	Yes	Yes
B/T industry × Year FE	Yes	Yes	Yes	Yes
Adjusted R-squared	0.051	0.048	0.051	0.052
F-statistic	11.039	12.391	11.287	11.816
Observations	21,468	21,468	21,468	21,468

Note: This table considers two potential factors moderating the trust effect on deal completion. In all models, the dependent variable takes the value of 1 if the deal is completed, and 0 otherwise. Panel A focuses on deal complexity, and Panel B on liability of foreignness. Each column of Panel A reports, respectively, on the following four deal complexity proxies: the merger dummy (i.e. the variable takes the value of 1 if the cross-border deal is a merger, and 0 otherwise); the stock payment dummy (i.e. the variable takes the value of 1 if 50% or more is paid with stocks, and 0 otherwise); the deal size (i.e. the log of the deal value); and the innovative target dummy (i.e. the variable takes the value of 1 if the target is from an innovative industry, and 0 otherwise). Each column of Panel B reports, respectively, on four variables depicting the severity of the liability of foreignness faced by the bidder: Distance Institutional Quality (i.e. the difference between the institutional quality of the bidder and target countries); Distance Expropriation Risk (i.e. the difference between the investment profile index of the bidder and target countries); Different Legal Origin (i.e. the variable takes the value of 1 if the bidder and target countries do not share the same legal origin, and 0 otherwise); and No Experience Target Country (i.e. the variable takes the value of 1 if the bidder has not done an M&A deal in the target country during the last three years prior to the focal deal announcement). All variables are defined in online Appendix A. The specifications control for a rich set of fixed effects (FEs). The adopted industry definition is the 2-digit SIC classification. Standard errors are corrected for heteroscedasticity at the bidder–target country–pair level. The p-value is reported in parentheses below the coefficient estimate. ***, **, and * indicate significance at 1%, 5%, and 10%, respectively.

Table 8. Bilateral trust and M&A performance

Panel A. Acquirer CAR (−3, +3)			
	(1)	(2)	(3)
Bilateral trust variables			
B→T	0.086** (0.017)		0.020*** (0.005)
T→B		0.113** (0.024)	0.010** (0.043)
Deal characteristics	Yes	Yes	Yes
Country characteristics	Yes	Yes	Yes
Country-pair characteristics	Yes	Yes	Yes
B/T country FE	Yes	Yes	Yes
B/T industry × Year FE	Yes	Yes	Yes
Adjusted R-squared	0.018	0.03	0.022
F-statistic	4.868	4.58	5.087
Observations	2,284	2,284	2,284
Panel B. Acquirer industry-adjusted ROA			
	(1)	(2)	(3)
Bilateral trust variables			
Post merger	−0.678*** (0.000)	−0.702*** (0.000)	−0.437*** (0.000)
Post merger × B→T	0.627*** (0.003)		0.103*** (0.002)
Post merger × T→B		0.722*** (0.001)	0.035 (0.235)
B→T	−0.511 (0.168)		−0.087 (0.128)
T→B		−0.283 (0.331)	0.002 (0.923)
Firm characteristics	Yes	Yes	Yes
Country characteristics	Yes	Yes	Yes
Country-pair characteristics	Yes	Yes	Yes
B firm FE	Yes	Yes	Yes
B industry × Year FE	Yes	Yes	Yes
Adjusted R-squared	0.555	0.552	0.552
F-statistic	169.00	167.70	155.80
Observations	92,516	92,516	92,516

Note: This table presents the effects of bilateral trust on M&A performance using OLS models. Panels A and B focus on stock performance and operating performance, respectively. In Panel A, the dependent variable is the acquirer's CAR (i.e. the cumulative abnormal returns computed over a 7-day window around the announcement of the deal). In Panel B, the dependent variable is the acquirer's industry-adjusted ROA. For each bidder in the sample, we consider a 6-year window from year −3 to year +2, with year 0 being the completion year. Post Merger is a dummy variable identifying the completion year and the two years after. In both panels, the independent variable of interest is Bilateral Trust. B and T denote, respectively, the bidder and the target firm, and the direction of the arrow identifies the origin and destination of trust. Column 3 relies on the orthogonalized trust variables. All variables are defined in online Appendix A. The models control for a rich set of fixed effects (FEs). The adopted industry definition is the 2-digit SIC classification. Standard errors are corrected for heteroscedasticity at the bidder–target country-pair level. The p-value is reported in parentheses below the coefficient estimate. ***, **, and * indicate significance at 1%, 5%, and 10%, respectively.

size, deal characteristics, and country and country-pair controls, as well as a dense set of fixed effects. For brevity, we report only the coefficient estimates of the independent variables of interest. The full model and a robustness check using an 11-day event window are reported in online Ap-

pendix D. The results indicate that both bilateral trust variables load with a positive and statistically significant coefficient estimate. In terms of economic significance, we find that a one standard deviation increase in trust and trustworthiness is associated with an increase in Acquirer CAR by a

value of 1.32% and 1.73%, respectively. This is a meaningful economic impact, given that the average Acquirer CAR is 1.30% in our sample.

Panel B of Table 8 reports the operating performance regressions, adopting a similar structure to in Panel A. The dependent variable is the acquirer's industry-adjusted ROA in percentage points. For each bidder in the sample, we consider a 6-year window from year -3 until year $+2$, with year 0 being the completion year. Post Merger is a dummy variable identifying the completion year and the 2 years after. The independent variable of interest is the interaction terms between bilateral trust and the post-merger dummy. In all models, the coefficient estimate of the interaction term is positive and statistically significant (except in column 3, when the post-merger dummy is interacted with the target's trust towards the bidder). The effect of bilateral trust on merger performance is clearly positive. In terms of economic effect, a one standard deviation increase in $B \rightarrow T$ is associated with a 0.096 percentage point increase in the acquirer's industry-adjusted ROA during the post-merger period. This corresponds to a substantial economic effect, given that the average industry-adjusted ROA is -0.968 percentage points in our sample. Collectively, our results are, therefore, more in support of the adopted rational economic perspective than of the behavioural aspect of trust.

Robustness checks

To further assess the robustness of our findings pertaining to M&A deal completion, we conduct several additional checks reported in online Appendix D.

We first repeat our test with a propensity-score-matching approach to make sure our results are not driven by systematic differences between completed and non-completed deals. If withdrawn deals are fundamentally different from those completed, then the control variables employed in the main specification that capture linear relations may be inadequate. Under this assumption, the results could be biased and may pick up non-linear effects of the control variables on deal completion. To alleviate this concern, we estimate propensity-score models for each year separately and match completed deals with withdrawn deals along the following deal characteristics: bidder size, private target firm, cash-only deal, financial

bidder, diversifying deal, and toehold. The results indicate that four of the deal characteristics differ significantly for the unmatched sample. As expected, however, almost all of the considered deal characteristics are statistically comparable for the matched sample. Using this matched sample, we re-run the baseline regressions as in Table 5. The results remain robust, reaffirming that the positive bilateral trust effect we find is not an artifact of functional form misspecification biases.

We also perform additional subsample analyses by removing deals with missing information on transaction values or acquiring firm size and excluding the three largest countries in our sample (i.e. the UK, Germany, and France). After removing deals with missing transaction values, the sample size drops from 21,468 observations to 5,427 observations. However, despite a substantial decrease in the sample size, the coefficient estimate of the bilateral trust variable remains positive and statistically highly significant. In an additional test, we augment the baseline specification with acquiring firm size as an additional control. The sample size is reduced to 10,918 observations this time. Controlling for acquiring firm size does not affect our main results. Finally, we remove from our sample the three largest countries, namely, the UK, France, and Germany, and re-estimate our baseline model. Our main finding is also robust to this alteration.

As a final robustness check, we implement a placebo test, which consists in assigning randomly the bilateral trust score in our sample to country pairs before running the regression analysis. The coefficient estimate of the randomly assigned trust score is statistically insignificant, confirming the robustness of our baseline results.

Conclusion

This study has investigated the role of bilateral trust in cross-border M&As, which so far has received little attention in the literature. Based on a large sample of European M&As, our findings offer a robust, broad, but also nuanced view of the relevance of bilateral trust during the M&A process.

First, we pointed out that the effect of trust is not symmetric at every stage of the M&A process. While the bidder and target firm bilateral trusts

towards each other are both important for deal announcement, our findings suggest that only bidder trust towards the target firm affects the deal completion. Thereby, this study confirms and extends the preliminary insights of Graebner (2009) in her qualitative study involving M&As of entrepreneurial firms. Second, we showed that the impact of bilateral trust is higher in complex deals and when the bidder is facing severe liability of foreignness. We thereby contribute to delineating the conditions under which bilateral trust is particularly valuable to the M&A negotiation process and outcome.

Focusing on European cross-border M&A deals, this study thus sheds light on an important factor that is likely to influence the pre-M&A deal phase. An area for future research would be, for instance, to increase the external validity of our findings by looking at the role of bilateral trust in other regions of the world. The implication of bilateral trust in post-M&A restructuring and performance also deserves attention.

Acknowledgements

We are grateful to Azizjon Alimov, Olivier Bertrand, Varun Jindal (discussant), Markus Lithell, Vesa Pursiainen, Robert Reardon (discussant), Tereza Tykvova, and participants at the 2nd Boca Corporate Finance and Governance conference, 2022 FMA Global conference, and the International French Finance Association (AFFI) May 2022 conference for helpful comments and suggestions. This research did not receive any specific grant from funding agencies in the public, commercial, or not-for-profit sectors.

Open access funding enabled and organized by Projekt DEAL.

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Supporting Information

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