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Ownership and M&A Performance in a Transitional Economy: The Case of the Chinese Real Estate Industry

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ABSTRACT In a transitional economy such as China's, when resources are unevenly distributed across different sectors, the disadvantaged sector may seek a growth path that bypasses resource constraints. We investigated this phenomenon in the context of the Chinese real estate industry. By comparing the post–merger and acquisition (M&A) performance of acquiring firms between state-owned enterprises (SOEs) and privately-owned enterprises (POEs), we attempted to show that POEs are better performers in the market should they be granted equitable resources, and the superior performance is strengthened by market-oriented institutional environment. We used M&A events data of publicly listed real estate firms in China from 2004 to 2012, in conjunction with firm characteristics and province-level market environment data. We found the results to be consistent with our hypotheses. In particular, compared to SOEs, privately-owned acquiring firms tend to have better post-M&A performance when both the regions of the acquirer and the target have high level of marketization. The results suggest that the private sector in China's transitional economy is potentially more efficient than the state-owned sector, as long as the market environment is favorable.

KEYWORDS M&A performance, market environment, ownership, real estate industry, transitional economy

INTRODUCTION

Through mergers and acquisitions (M&As), acquiring firms seek to advance financial capability and increase firm value. Previous studies suggest that firms' M&A performance might be influenced by acquiring firms' previous M&A experience, the prior relationship between the acquiring and target firms, the organization structure of the acquiring firm, and the payment method of M&A (Agrawal, Jaffe, & Mandelker, 1992; Hayward, 2002; Hayward & Hambrick, 1997; Walker, 2000). Despite the above, the conventional wisdom about why M&As fail to improve the performance of the acquiring firm is entrenched in the divergent interests between the owners and the managers of the acquiring firm (Bebchuk & Grinstein, 2005; Hayward & Hambrick, 1997; Roll, 1986).

In an emerging economy such as that of China, the divergent interest between the managers of state-owned enterprises (SOEs) and the state owners generates severe problems affecting firm efficiency in decision-making and operation (Kornai, 1986; Kornai, Maskin, & Roland, 2003). However, SOEs in an emerging economy may obtain various support and resources from the government, such as better material supplies and distribution networks (Luo & Tan, 1998), or easier access to financing from state-controlled banks and government bailouts (Buckley, Clegg, Cross, Liu, Voss, & Zheng, 2007; Faccio, Masulis, & McConnell, 2006; Nguyen, Le, & Bryant, 2013). Regardless of a series of reforms to privatize the state-owned sector and establish privately-owned enterprises (POEs) in the economy (McMillan & Woodruff, 2002), SOEs have regained momentum in recent years (Meyer, 2011). The debate over the appropriate role of the state in economic organizations and the implications for state ownership continues to be waged (Micklethwait, 2011). To extend this line of thinking, our study investigates the difference in post-M&A performance between SOEs and POEs and further examines how different regional institutions may influence the post-M&A performance gap between SOEs and POEs in China's transitional economy.

During the institutional transition, the variance of institutional settings affects firms' performance (Kogut & Zander, 2000). In transitional economies, market-facilitating institutions, such as property rights protection, capital markets, labor markets, and regulatory authorities, are not as well developed as they are in developed economies (Allen, Qian, & Qian, 2005). Furthermore, different from developed economies, large-scale transitional economies such as China have imbalanced development of institutional environments across subregions (Chan, Makino, & Isobe, 2010). It is of particular interest in the present study to investigate how the heterogeneous institutional environments of the acquiring and target firms will affect the post-M&A performance of different types of acquiring firms.

The real estate industry in China, one of the most heavily intervened industries by the Chinese government (Tian & Ma, 2009), becomes an appropriate setting to observe the impact of ownership difference and institutional variance on firm M&A performance. In China, urban land is officially owned by the state, whereas rural land is collectively owned (Ding, 2003; Ho & Lin, 2003). The state controls the land market through its monopolization of the sale of land-use rights. Compared to POEs, the state-owned developers have better opportunities to secure land due to their closer relationship with the government, which owns the ultimate rights over the land (Zhang, 2012).

In recent years, there have been a large number of M&A events in the Chinese real estate industry, allowing detailed investigation of the research question. M&As provide acquiring firms with unique access to valuable resources held by target firms (Das & Teng, 2000; Wernerfelt, 1984). Real estate developers may secure land from target firms through M&As, because land is a major asset of firms, and the transaction of pure land ownership between firms is not permitted in China. Therefore, the key motive for firms in the real estate industry to acquire other

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firms is to obtain the major asset of the industry and grow. For historical reasons, a substantial amount of urban lands were allocated to SOEs. These SOEs became acquiring targets in the process of reform and restructuring, especially attracting cross-region M&As.

Cross-region M&As within Mainland China inevitably face the difficulty of dealing with heterogeneous institutional environments. The decentralization of control from the central to local governments has allocated the rights of revenue collection to local governments, leading to the autonomy of the regional government and the variation in institutional environments across regions (Tsui, 2005; Wong, 2000; Xu, 2011). China has formed a mixture of legal, administrative, and market mechanisms where the market plays an 'invisible hand' role, with the local government's intervention (Tan, Li, & Xia, 2007). Since China has a vast disparity in terms of the depth of market economy across regions and provinces (Fan, Wang, & Zhu, 2010), companies do not face a uniform institutional environment when they operate business in different locations of the country. When real estate companies pursue M&As across regions, they need to adapt to different environments, and the institutional differences influence M&A activities and performance.

We compared the post-M&A performance between SOEs and POEs and further examined the institutional influence on the difference. In so doing, we were able to demonstrate that a particular kind of institutional environment may benefit the development of the private sector. Our empirical results indicate that, in general, privately-owned acquiring firms outperform SOEs, and such advantage is stronger when both the regions of the acquiring firm and the target firm have a high level of marketization but weaker to none when either of the regions has a low level of marketization.

This study contributes to both theory building and practical policymaking. First, it extends the theory of corporate governance by suggesting that the ownership structure not only influences firms' performance, but also has an impact on firms' post-M&A performance. Second, the study examined the subnational institutions' impact on firms' post-M&A performance. It adds to our understanding of the heterogeneity of institutions in institutional theory. The heterogeneity of institutional environment complicates the M&A process from both the acquiring and target firm sides. It guides our thinking about cross-region M&As in different institutional environments in a transitional economy context. Third, our study advocates possible solutions to private firm owners and managers alike in the transitional economy that M&As might be an effective way to overcome the resource constraints and grow in such an institutional environment.

THEORETICAL BACKGROUND AND HYPOTHESES

On the basis of a survey of 334 published articles on M&As in the top 16 leading business journals from 1980 to 2010, Santos, Ferreira, Reis, and Almeida

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(2012) concluded that no single theory is dominant in M&A research; most M&A research is based on four theoretical perspectives: agency theory, institutional theory, transaction cost theory, and resource-based view. Research has shown that institutional environments generate various constraints under which a rational economic actor makes a decision, consequently affecting behaviors and outcomes (La Porta, Lopea-de-Silanes, Shleifer, & Vishny, 1997; Lee, Peng, & Barney, 2007; Peng, Sun, Pinkham, & Chen, 2009). For studying firm strategies in emerging economies, institutional theory has also been recognized as one of the most relevant perspectives (Hoskisson, Eden, Lau, & Wright, 2000; Nguyen et al., 2013; Peng et al., 2009; Wright, Filatotchev, Hoskisson, & Peng, 2005). However, treating institutions as only a background will hinder deeper understanding of a firm's strategic behavior (e.g., Clougherty, 2005; Oliver & Holzinger, 2008), and the deficiency can be more salient in emerging economies such as China where the institutional arrangements are quite distinct from the developed economies (Lau & Bruton, 2008). Consistent with the call for research on the effects of a firm's external environment on managing resources (Bettis & Hitt, 1995; Sirmon, Hitt, & Ireland, 2007), M&A research has also been increasingly focusing on the effects of institutional environments, including governmental, societal, and political, on firm performance (Santos et al., 2012).

Rising to the preeminent position in strategy research over the past two decades or so (Lockett, Thompson, & Morgenstern, 2009), the resource-based view stresses that a firm's competitive advantage lies in the firm's unique resources that are valuable, rare, inimitable, and non-substitutable (Barney, 1986, 1991; Wernerfelt, 1984). Through M&As, firms may gain a shortcut access to or control over these kinds of unique resources (Barkema & Vermeulen, 1998; Karim & Mitchell, 2000). It is not the resource *per se* that matters, but how the resource is employed to explain performance differences (Peteraf & Bergen, 2003; Wernerfelt, 1984). Therefore, acquiring firms may benefit from their investments when they create a uniquely valuable combination of their assets with those of the acquired firm.

Institutional context is considered crucial to influence resource decisions to achieve firm competitive advantage (Oliver, 1997). Recent research has called for the integration of the resource-based view and the institutional perspective on examining firm strategy, behavior, and performance in emerging economies (Peng, 2003; Peng et al., 2009). In emerging economies, scholars particularly emphasize the impact of institutions on firm strategic decisions, resource acquisition, and firm performance (Peng, Wang, & Jiang, 2008; Yamakawa, Peng, & Deeds, 2008). For instance, some researchers have examined the impact of market-supporting institutions on entry strategies when foreign investors enter emerging economies (Meyer, Estrin, Bhaumik, & Peng, 2009). Aligned with this stream of research, the present study shows how the institutional environment at a subnational level affects POEs' performance against SOEs when M&A is employed as a strategic choice in China's transitional economy.

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Ownership Difference in Acquiring Firms' M&A Performance

In a transitional economy, connections with government provide firms a favorable environment in which to operate businesses (Peng & Luo, 2000). SOEs tend to have convenient access to critical resources, such as better material supplies and distribution networks (Luo & Tan, 1998), and financial capital from state-controlled banks and government bailouts (Faccio et al., 2006; Nguyen et al., 2013), due to the incentive alignment with government brought about by state ownership. SOEs gain through resource leverage with help from the government relationship in enhanced financial performance (Sun, Tong, & Tong, 2002), improved operation efficiency (Tian & Estrin, 2008), and increased innovative capacity (Steensma & Yang, 2013).

However, support from government is a double-edged sword. Most prominently, the 'soft budget' constraint of state ownership hampers the incentives of SOE managers to compete in the market (Kornai, 1986; Kornai et al., 2003; Ramamurti, 2000). This incentive issue is evidenced by the finding that state-owned firms' easy access to long-term debt is positively associated with long-term investment and negatively associated with firm performance (Li, Yue, & Zhao, 2009). Private owners, in contrast, have the incentive to maximize the performance of their firms and are disciplined by threats of bankruptcy and takeover (Hanke, 1987), which is supported by research findings that, together with collectively-owned enterprises, POEs outperform SOEs in profitability and productivity when controlling for tax rate (Park, Li, & Tse, 2006).

Furthermore, the government is concerned with its own interests and extorts profits from businesses (Frye & Shleifer, 1997; Shleifer & Vishny, 1998). Political objectives such as maintaining employment instead of maximizing profits hurt SOEs' efficiency (Boycko, Shleifer, & Vishny, 1996; Estrin & Perotin, 1991). To make things worse, these political objectives often change from one administration to the next, generating uncertainty of government policies that hampers the efficiency of SOEs' operation and governance and hinders enterprise restructuring (Frydman, Hessel, & Rapaczynski, 1998; Netter & Megginson, 2001). As a trade-off of government support, SOEs may suffer from political control in the selection and replacement of top managers, who are appointed directly by the government (Xu, Zhu, & Lin, 2005). This creates uncertainties at the organizational level, impeding the management and control of the firm. Due to their close relationship with the government, SOEs suffer more than POEs from government intervention (Netter & Megginson, 2001).

Following the reasons above, we offer several explanations for the potential superior post-M&A performance of POEs over SOEs. First, POEs and SOEs differ in motives when selecting M&A targets. The selection of the acquiring target affects the performance of the acquiring firm. As an independent and rational market player, a POE is more likely to follow the rules of profit maximization to select acquiring targets. In contrast, regardless of business feasibility, SOEs are likely to follow government's political goals, such as a plan of industrial restructuring or

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individual promotion (Brouthers & Bamossy, 1997; Uhlenbruck & De Castro, 2000). On the contrary, POEs tend to select M&A targets based upon market-oriented motivation to integrate and recombine the resources in order to achieve synergy and better firm performance. Different motives lead to different outcomes. Non-market-oriented M&A motives of SOEs lead to lower M&A market performance, while market-oriented POEs' M&A motives lead to higher M&A market performance.

Second, the multiple goals of SOE acquiring firms will distract their effort from consolidating the target firm's resources and assets in an effective way. For example, in order to maintain employment, SOEs are less likely to downsize the acquired target. Lack of management knowledge and skills also hampers how acquiring firms integrate and make use of the target firm to achieve synergy. Given the external intervention from government and internal lack of management knowledge, SOEs may not be able to effectively integrate the acquired firm. As evident in Zhang, Zhou, and Ebbers (2011), Chinese SOEs are less likely to succeed in an overseas acquisition than are other types of acquiring enterprises.

Third, post-M&A communication between the acquiring firm and the target firm is vital for M&A success (Stahl & Sitkin, 2005). The bureaucracy regime of SOEs generates conflicts and difficulties during the post-M&A process, especially when sufficient value exchanges and communications are missing (Ellis, Reus, & Lamont, 2009). Even though both the acquiring firm and the target firm are SOEs, they cannot establish an effective communication mechanism and integrate (Zhang et al., 2011). In contrast, POE acquiring firms may be able to take advantage of their flexibility and effectiveness to select an M&A target and successfully integrate the target company to achieve synergy and competitive advantage.

In the Chinese real estate industry, due to the institutional background described above, privately-owned developers cannot compete with state-owned developers, especially the largest central-government-owned ones, in acquiring land from the government. Therefore, M&As are the alternative for the POEs in the industry to acquire this important resource and grow. As M&As are relatively competitive business activities, we expect POEs to perform better than SOEs as acquiring firms.

Hypothesis 1: The post-M&A performance of POEs as acquiring firms will be better than that of SOEs as acquiring firms in China's real estate industry.

Institutional Influence, Ownership, and Acquiring Firms' M&A Performance

Institutional environments are able to influence the firm's decision-making, behavior, and performance (La Porta et al., 1997; Lee, Peng, & Barney, 2007; Peng et al., 2009). For example, Vaaler and Schrage (2009) found that policy stability affects firms' choice of residual state ownership. Although some policies are set at the national level, the implementation is often carried out at the regional

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level (Meyer & Nguyen, 2005). Different regions in China have formed quite diverse cultural and institutional settings due to historical and political factors (Xu, 2011). Fan et al. (2010) generated a provincial level marketization index that incorporates factors such as government-market relationships, development of the nonstate sector, market intermediaries, and contract enforcement, indicating that the development of the institutional environment varies greatly across provincial regions in China. Consequently, firms develop different capabilities, such as market and nonmarket capabilities, to adapt to the distinct institutional environments (Griffiths & Zammuto, 2005; Wan, 2005).

Market-facilitating institutions typically encompass several key features: effective legal framework and its enforcement, sufficient protection of property rights, transparent information systems, and rigorous regulatory regimes (Meyer et al., 2009). The quality of such institutions, where either the acquiring firm or the target firm operates, affects the integration process and post-M&A performance of SOE or POE acquiring firms. SOE and POE firms have their distinct competitive advantages in the transitional market. SOEs have access to rare resources under the control of the government (Li & Xia, 2008; Peng, Tan, & Tong, 2004), whereas POEs are more efficient and effective to adapt to market changes (Peng et al., 2004; Tan, 2002). In particular, when both the acquiring and target firms are in the environment with high level of marketization, POEs are able to use their advantageous position over SOEs to select and access target firms and to obtain sufficient resources and support from the institutional environment to integrate target firms. Therefore, POEs are more likely to achieve synergy and enhance the competitive advantages through M&A activities in such a favorable institutional environment. In the following, we further illustrate the institutional effects of the target firm's region, acquiring firm's region, and their combinational effects on the ownership difference in firm post-M&A performance.

When the target firm is in a region with a high level of marketization, the local government tends to help to overcome resource constraints by liberalizing markets within its authority to attract investment (Meyer & Nguyen, 2005), suggesting fewer interventions in target firms' business operations. On the other hand, well-developed regions, compared to underdeveloped regions, have easier access to the statistics and information about market size, economic growth, infrastructure, investment policies, business partners, and their likely behaviors (He, 2002). Available information contributes to reducing information asymmetry and transaction costs of undertaking the due diligence and contract negotiations necessary for acquisitions and post-M&A restructuring (Peng, 2006). The efficiency and effectiveness of POEs can be more prominent than SOEs, since market-facilitating institutions usually come with sufficient competition. Based upon their advantageous market knowledge and management skills, POEs have better capabilities than SOEs to identify the potential value of acquisition and to select the target firm accordingly. In addition, a good market institution of the target firm ensures investor protection in order to accomplish M&A integration and

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share continuous interests, generating gains for the acquiring firm (Moeller & Schlingemann, 2005).

When the acquiring firm is in a region with a high level of marketization, the market institutions affect the acquiring firm's overall competitive capabilities (Capron & Guillén, 2009). Without resource constraints *vis-à-vis* SOEs, POE acquiring firms tend to hold favorable positions against SOE counterparts in competitive markets with well-established institutions. For instance, banks in the regions equipped with better institutions may reduce discrimination against the private sector, whereas more available alternative financing channels may alleviate financial constraints over private firms (Li et al., 2009), and the specialized market intermediaries such as law firms and accounting firms in the well-established market may have enough knowledge to deal with various problems in the M&A transaction process. However, SOEs may lose their competitive advantage, since they have less opportunity to obtain additional support from government. Under such circumstances, market-based capabilities rather than interpersonal relationships (for example, political ties) are gradually implemented to achieve good performance (Luo, Huang, & Wang, 2012; Peng et al., 2008).

The market-oriented institutional environment on both acquiring and target sides provides a most favorable environment for POE acquiring firms to leverage their competitive advantage potential and results in superior post-M&A performance. In the post-M&A stage, the integration between the acquiring and target firms is affected by the organizational culture and administrative structure embedded in their regions, respectively. The compatibility of the organizational culture and administrative structure between the acquiring and target firms assists the communication between the two organizations and facilitates learning (Brock, 2005; Vermeulen & Barkema, 2001). On the contrary, unsuccessful integration directly impedes the synergy or competitive advantage the acquiring firm wants to achieve (Appelbaum, Gandell, Yortis, Proper, & Jobin, 2000). In summary, although the high quality of both the acquiring firm and the target firm can benefit both POEs and SOEs, POEs will gain more while SOEs' relative advantage from government support and intervention will decline; therefore, POEs' competitive advantage over SOEs can be strengthened in achieving superior post-M&A performance.

In contrast, underdeveloped market institutions spawn obstacles in the M&A process, preventing POEs from demonstrating competitive advantages over SOEs. When target firms are in regions with low level of marketization, government intervention and volatility in the policy regime hinders M&A target assessment and selection (Aybar & Ficici, 2009). When acquiring firms are in regions with low level of marketization, it is difficult for POEs to accumulate adequate market knowledge under serious resource constraint. SOE acquiring firms may obtain additional support of favorable resources such as financial capital from the government. However, that support is likely attached to nonmarket goals of the government.

Even though the acquiring firm is from a region with relatively high level of marketization, it still faces the uncertainty and complexity of choosing a valuable

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target firm in a region with a relatively low level of marketization. Overall, if the institutional difference between the acquiring firm in a region with a high level of marketization and the target firm in a region with a low level of marketization is substantial, it will hamper the M&A performance by preventing synergy and learning (Vermeulen & Barkema, 2001).

In summary, only when both the acquiring and target firms are in developed market institutions is the post-M&A performance difference between POE and SOE acquiring firms more pronounced. When either the target or acquiring firm is in an underdeveloped market environment, the intervention of government and imbalanced distribution of key resources will impede the M&A motive, process, and post-M&A integration, leading to the diminishing of the competitive advantage of POEs over SOEs.

Hypothesis 2: The superior post-M&A performance of POEs over SOEs as acquiring firms will be stronger when both the acquiring and target firm regions are of high level of marketization than the other three situations when either the acquiring or the target firm region is of low level of marketization.

METHOD

Sample

We used a sample of Chinese publicly listed real estate firms from the Wind M&A database, which is provided by the Wind Information Company, a leading financial data provider in Mainland China. The initial sample included completed Chinese M&A events in which acquiring firms are listed real estate developers in the main board (A-share) market. We recorded the date of disclosure of a deal as the event date. After linking to the provincial statistical data, the sample spans from 2004 to 2012. We adopted several criteria to organize unusual events. First, we removed the events that were conducted by the related parties of the acquiring firms. These events were not directly conducted by the listed acquiring firms themselves, but were required to be reported by the acquiring firms and, therefore, included in the database. Second, if one event occurs through several phases within a year, we combined the different transactions into one event. Third, if one acquiring firm acquires different targets within one year, we treated them as different events. Last, we used trade volume to control for the effect on the acquiring firm's performance.

The sample includes a total of 599 events. For each event, we recorded information on the event date; ownership status of the acquiring firm; ownership status of the target firm; acquisition type (share or asset acquisition); proportion of shareholding on the target firm; trade volume; business relatedness of the acquiring firm and the target firm; age and size of the acquiring firm; acquisition experience of the acquiring firm; locations of the acquiring firm and the target firm; GDP per

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capita of their provinces; and year-end financial data. Regarding the information that is not released in the database, we checked the details from individual M&A public reports. According to China Stock Exchange regulation, the publicly listed firms are required to release an announcement when there is an event potentially causing substantial stock price fluctuation. All of the public reports are released by listed firms according to the information disclosure regulation under the supervision of the China Securities Regulatory Commission.

We also collected information about market environment for the 31 province-level administrative regions, including provinces and municipalities in Mainland China (Fan et al., 2010), and matched the data with the regions of the acquiring firm and the targets in each M&A event. We used the registration place as the acquiring firm's region and checked the M&A public reports for the target's region.

Among the sample M&A events, 81% are business-related M&As, indicating the clear attempt to acquire the core resource, the land, through M&As. As a matter of fact, more M&A events occurred in the eastern area than the rest of the country. Guangdong, Shanghai, Zhejiang, Beijing, and Tianjin are the top five province-level regions hosting M&A events, accounting for about 71.45% of total M&A events as the origin of the acquiring firms and about 58.26% as the home of the target firms. Also, the M&As boomed in 2008 when the number of M&A events reached 144, more than 8 times higher than that in the previous year, indicating that real estate firms may be more willing to pursue M&As during financial crises because of the lower asset value than that during typical times.

Measures

Dependent variable. We used *Tobin's Q* as the dependent variable to measure post-M&A performance of the acquiring firms. *Tobin's Q* is a common indicator of expected long-run firm performance, which is calculated as the ratio of the market value to the replacement cost of a firm (Lindenberg & Ross, 1981). In the regression analyses, we used the difference of the current and the previous year-end data to capture the potential performance balance achieved from the M&A events in the past year. Therefore, the dependent variable is Δ*Tobin's Q*. This indicator, along with some others, is often used by researchers to examine the performance change that is generally seen as the result of M&A events (Bruner, 2002).

Independent variables. Acquiring firm ownership is a dichotomous variable indicating the ownership type of the acquiring firm. It is characterized by two groups: 1 if the acquiring firm is a POE, 0 if the acquiring firm is a SOE. We used ownership type of the actual controller of the acquiring firm to measure this variable. In most cases, the actual controller is the largest shareholder. Only in rare cases is the actual controller not the largest shareholder but instead controls the company through particular agreements or arrangements. In the Chinese context, although the firm's actual controller may not be the largest shareholder at times, the firm tends to follow

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the behavioral and performance patterns of a sole ownership type (Li, Xia, Long, & Tan, 2012).

Control variables. We controlled for a number of other factors that might impact firm performance from M&As, which can be classified by three dimensions: deal characteristics, firm characteristics, and characteristics of the firm's region. There are five control variables of deal characteristics. *Acquisition type (share or asset acquisition)* is 1 if the target is stock equity, and 0 if the target is asset. *Proportion of shareholding* is the percentage of the target's total shares that the acquiring firm obtained through an M&A event, indicating the degree of transfer of control right from the target firm to the acquiring firm; for asset targets, the value of the variable is 0. *Volume-to-size ratio* is the amount paid by the acquiring firm for the M&A event divided by the acquiring firm's previous year's total assets. *Relatedness* is captured as a dummy variable coded as 1 if the business of the target firm is related to real estate, such as property development, property management, and construction, and 0 if otherwise. *Target firm ownership* is 1 if the target is owned by a POE, and 0 if the target is owned by an SOE.

Several firm characteristic variables are controlled for. *Size* is the natural log of the acquiring firm's book value of total assets at the end of last year. Studies have shown that firm size can systematically affect a range of strategic and performance variables (for example, Keats & Hitt, 1988) and acquiring firms' M&A performance (Bruner, 2002). *Age* is the duration of the firm from the founding year to the year that the M&A event occurred. *Experience* is the level of general acquisition experience, a simple count of the accumulated number of M&As previously completed by the same acquiring firm.

In addition, there are control variables related to characteristics of the firm's provincial location. *Same region* is 1 if both the acquiring firm and the target firm are in the same province, and 0 otherwise. *Acquiring firm GDP per capita* and *target firm GDP per capita* are the logarithm of GDP per capita of the acquiring firm province and the target firm province of the previous year, respectively, measuring the economic development of the regions. We included *year* dichotomous variables for the period 2004–2012. Table 1 provides descriptive statistics and Pearson correlations for the variables.

Following Fan et al. (2010), we constructed two variables to describe the market environment in which the M&A events occurred. First, the degree of *proportion of market allocation of resources (PMAR)* was 1 minus the ratio of provincial government expenditure to provincial GDP, reversely indicating the degree of government interference in a province. In the analysis, we constructed the indicator for acquiring firms and target firms separately. Second, the *social fixed asset invested by non-state-owned sector (SFAINS)* was 1 minus the ratio of social fixed asset invested by state-owned sector to the total social fixed asset investment at the provincial level, suggesting the depth of private investment in the region. We also constructed separately the variable for acquiring firms and target firms.

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Table 1. Descriptive statistics and Pearson correlations

	Variables	*Mean*	*S.D.*	*1*	*2*	*3*	*4*	*5*	*6*	*7*	*8*	*9*	*10*	*11*	*12*
1	Tobin's Q	–3.10	23.10												
2	Acquiring Firm Ownership	0.53	0.50	–0.11***											
3	Share or Asset	0.90	0.30	0.00	0.10**										
4	Proportion of Shareholding	0.51	0.36	–0.04	0.13***	0.46***									
5	Volume-to-Size Ratio	3.21	38.61	–0.67***	0.076*	0.02	0.08*								
6	Relatedness	0.81	0.39	–0.06	–0.05	–0.08*	0.02	0.04							
7	Size	9.47	0.68	0.62***	–0.36***	0.10**	–0.07*	–0.40***	0.07						
8	Age	15.12	3.93	–0.15***	0.29***	0.14***	0.08**	0.10**	–0.02	–0.06					
9	Experience	4.16	5.19	–0.01	–0.01	0.11***	0.01	–0.03	0.14***	0.20***	0.12***				
10	Target Firm Ownership	0.66	0.47	–0.09**	0.59***	0.10**	0.10**	0.06	–0.01	–0.26***	0.16***	0.02			
11	Same Region	0.59	0.49	–0.07*	–0.20***	–0.20***	–0.19***	0.04	–0.04	0.071*	–0.15***	0.05	–0.18***		
12	Acquiring Firm GDP per Capita	4.55	0.25	–0.04	–0.18***	0.13***	–0.01	0.02	0.11***	0.33***	0.16***	0.30***	–0.10**	0.10**	
13	Target Firm GDP per Capita	4.52	0.26	–0.05	–0.18***	0.10**	0.04	0.03	0.12***	0.26***	0.19***	0.27***	–0.11***	0.24***	0.66***

Notes: [a] N = 599, * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$ (two-sided test).

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Analysis

We adopted multivariate linear regressions to investigate the main relationship between ownership type of the acquiring firms and M&A performance, as measured by Δ*Tobin's Q*. We further divided the full sample into four groups by the median of the two dimensional variables that measure the degree of favorable market environment for POEs in the acquiring firm's and the target's regions, *PMAR* and *SFAINS*, respectively. If both the acquiring firm and the target firm are in regions with high (above median) *PMAR (SFAINS)* level, we labeled the group as a High-High (H-H) group. By the same token, we constructed groups of L-L, H-L, and L-H. Each group includes a different number of M&A events.

Evidently, M&A events were more likely to occur between regions with similar levels of market characteristics. By the *PMAR* dimension, 230 of the 599 total events (or 38%) occurred in the H-H group, and 228 (or 38%) occurred in the L-L group; only 80 and 61 events each (13% and 10%, respectively) occurred in the H-L and L-H groups. By the *SFAINS* dimension, 239 of the 599 total events (or 40%) occurred in the H-H group, and 238 (or 40%) took place in the L-L group; only 61 events (or around 10%) occurred in both the H-L and L-H groups.

RESULTS

We summarize the regression results of ownership difference in M&A performance of acquiring firms in Tables 2 and 3, according to the two dimensions of marketization levels measured by *PMAR* and *SFAINS* in the acquiring firm's and the target's regions, respectively, with control over other confounding factors. We found supportive results with Hypothesis 1 in the estimates using Δ*Tobin's Q* as the dependent variable (first columns in Tables 2 and 3, $p < 0.01$), which indicates more performance improvement from M&As initiated by POEs than SOEs. To dispel potential concern with the self-selection issue, for instance, the lower performance of SOEs is not driven by their lower competence, but rather it is declining performance that drives them to acquire, we checked the previous performance, as measured by *Tobin's Q*, of SOE acquiring firms three years prior to M&As and did not find an obvious pattern of performance decline.

We further examined the M&A effects on the acquiring firms' performance under four different scenarios of market environment. The H-H scenario suggests that the M&A event occurs between regions both with high level of marketization, measured by the (reversed) degree of government intervention (*PMAR*) or the degree of nonstate investment (*SFAINS*). By the same token, we have three other scenarios that are labeled L-L, H-L, and L-H. From these sets of analyses, we attempted to show the exact market institutional environment that may be more suitable for POEs in terms of more evidently demonstrating their competitive advantages *vis-à-vis* SOEs.

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Table 2. Ownership difference in M&A performance of acquiring firms – *PMAR*

Models *ΔTobin's Q*	*(1)* *Total*	*(2)* *H-H*	*(3)* *L-L*	*(4)* *H-L*	*(5)* *L-H*
Independent Variable					
Acquiring Firm Ownership	4.47***	12.51***	0.27*	0.27	–0.37
	(1.58)	(3.51)	(0.14)	(0.34)	(0.82)
Control Variables					
Deal Characteristics Share/Asset	–2.99	–2.39	–0.04	0.08	—
	(2.30)	(4.34)	(0.17)	(0.69)	—
Proportion of Shareholding	2.34	1.79	–0.09	0.47	1.05
	(1.88)	(3.65)	(0.16)	(0.36)	(1.07)
Volume-to-Size Ratio	–0.24***	–0.12***	–0.51***	0.28	–0.53***
	(0.02)	(0.02)	(0.06)	(1.69)	(0.11)
Relatedness	–3.31**	–0.24	0.25*	0.28	–0.40
	(1.60)	(3.23)	(0.13)	(0.31)	(1.05)
Target Firm Ownership	0.73	–3.36	0.01	0.11	0.89
	(1.55)	(3.54)	(0.12)	(0.34)	(0.92)
Firm Characteristics					
Size	19.84***	35.98***	0.02	0.11	2.57***
	(1.14)	(1.90)	(0.13)	(0.34)	(0.61)
Age	–0.13	0.680*	0.03	–0.01	–0.01
	(0.20)	(0.37)	(0.02)	(0.05)	(0.10)
Experience	–0.16	–0.37	–0.04***	–0.02	–0.02
	(0.12)	(0.28)	(0.01)	(0.02)	(0.11)
Characteristics of the Firm's Region					
Same Region	–3.32**	–0.62	0.09	—	—
	(1.30)	(2.97)	(0.14)	—	—
Acquiring Firm GDP per Capita	–10.20***	–44.41***	–0.01	0.91	–0.18
	(3.39)	(13.80)	(0.27)	(1.25)	(1.53)
Target Firm GDP per Capita	0.04	2.30	0.24	–0.02	3.43
	(3.17)	(13.16)	(0.27)	(0.38)	(3.48)
Year	Year (2004–2012)				
R^2	0.64	0.81	0.65	0.42	0.78
Adj. R^2	0.62	0.79	0.62	0.23	0.68
F	50.30***	44.04***	19.14***	2.24***	8.04***
N	599	230	228	80	61

Notes: *p < 0.10, **p < 0.05, ***p < 0.01 (two-sided test). H-H: both the acquiring firm and the target firm are in the regions with high (above median) level of marketization (measured by PMAR); L-L: both the acquiring firm and the target firm are in the regions with low level of marketization. H-L: the acquiring firm is in the region with high level of marketization, while the target firm is in the region with low level of marketization. L-H: the acquiring firm is in the region with low level of marketization, while the target firm is in the region with high level of marketization.

Table 2 presents results when the sample is divided into groups by the *PMAR* dimension. First, looking at the H-H column, when both the acquiring firm and the target firm are in regions with high level of *PMAR*, privately-owned acquiring firms achieve better-than-SOEs M&A performance, as measured by *ΔTobin's Q* ($p < 0.01$). This result supports Hypothesis 2. Second, the results also suggest that privately-owned acquiring firms may perform better than SOEs in scenario L-L to a much lesser degree ($p < 0.10$), and the comparison of M&A performance

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Table 3. Ownership difference in M&A performance of acquiring firms – *SFAINS*

Models	*(1)*	*(2)*	*(3)*	*(4)*	*(5)*
ΔTobin's Q	*Total*	*H-H*	*L-L*	*H-L*	*L-H*
Independent Variable					
Acquiring Firm Ownership	4.47***	9.28***	0.18	0.60	0.34
	(1.58)	(3.37)	(0.13)	(0.40)	(1.34)
Control Variables					
Deal Characteristics Share/Asset	–2.99	4.32	–0.02	0.41	–3.08
	(2.30)	(5.29)	(0.14)	(0.88)	(3.85)
Proportion of Shareholding	2.34	0.00	–0.22	–0.14	1.45
	(1.88)	(3.38)	(0.15)	(0.56)	(0.96)
Volume-to-Size Ratio	–0.24***	–0.13***	–0.22**	1.26	–0.37***
	(0.02)	(0.02)	(0.09)	(2.22)	(0.10)
Relatedness	–3.31**	–4.68	0.10	0.16	0.26
	(1.60)	(3.61)	(0.11)	(0.41)	(1.08)
Target Firm Ownership	0.73	3.96	0.04	0.02	0.55
	(1.55)	(3.43)	(0.10)	(0.41)	(1.19)
Firm Characteristics					
Size	19.84***	34.45***	–0.19	0.06	3.75***
	(1.14)	(1.89)	(0.13)	(0.35)	(0.68)
Age	–0.13	0.32	0.01	0.00	–0.13
	(0.20)	(0.37)	(0.02)	(0.06)	(0.20)
Experience	–0.16	–0.18	–0.03***	0.01	–0.13
	(0.12)	(0.25)	(0.01)	(0.04)	(0.11)
Characteristics of the Firm's Region					
Same Region	0.73	3.96	0.04	0.02	0.55
	(1.55)	(3.43)	(0.10)	(0.41)	(1.19)
Acquiring Firm GDP per Capita	–3.32**	–0.35	0.02	–	–
	(1.30)	(2.97)	(0.11)	–	–
Target Firm GDP per Capita	–10.20***	–26.97**	–0.02	–0.47	0.91
	(3.39)	(12.05)	(0.23)	(1.52)	(1.39)
Year	Year (2004–2012)				
R^2	0.64	0.80	0.62	0.45	0.83
Adj. R^2	0.62	0.78	0.58	0.20	0.75
F	50.30***	42.61***	17.36***	1.78*	10.50***
N	599	239	238	61	61

Notes: *p < 0.10, **p < 0.05, ***p < 0.01 (two-sided test). H-H: both the acquiring firm and the target firm are in the regions with high (above median) level of marketization (measured by SFAINS); L-L: both the acquiring firm and the target firm are in the regions with low level of marketization. H-L: the acquiring firm is in the region with high level of marketization, while the target firm is in the region with low level of marketization. L-H: the acquiring firm is in the region with low level of marketization, while the target firm is in the region with high level of marketization.

between POEs and SOEs in scenarios H-L and L-H is not evident. This set of results is consistent with Hypothesis 2.

Table 3 shows similar patterns of results when the sample is divided into groups by the *SFAINS* dimension, which is another way to consider the marketization level in the region. From the H-H column, we find privately-owned acquiring firms achieve better-than-SOEs M&A performance, as measured by *ΔTobin's Q* ($p < 0.01$), supporting Hypothesis 2. No evident difference between POEs and

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SOEs is found in the other three scenarios. These results are also consistent with Hypothesis 2.

To check the robustness of the previous results, we analyzed three sets of alternative explanation. First, in order to distinguish institutional influence from the level of growth of specific provincial real estate markets, we examined M&As that occurred in the same province with the same institutional environment. In our study, 351 of the 599 total events (or 59%) occurred in the same province. The results are consistent with the previous analyses: POEs are likely to have better M&A performance than SOEs when they are in supporting market-oriented institutional settings. Second, we checked how the institutional distance between the two regions affects the difference in M&A performance. The results show that similar institutional settings facilitate private firms to maintain advantage over SOEs in M&A activities. If the institutional distance between the acquiring firm and the target firm is too large, private ownership may not help or may even hurt M&A performance. Third, we made a two-year lag of the dependent variable to show the firm performance change after the M&A event. The results are consistent. For the interest of space, the results of robustness check are not shown here but are available from the authors upon request.

DISCUSSION

In this study, we investigated the post-M&A firm performance in the transitional economy context. Particularly, we compared and contrasted the post-M&A firm performance between SOEs and POEs. We further examined the moderating role of the institutional context at the subnational level. We found that POEs' performance is generally better than that of SOEs in M&A activities, and the performance gap is more pronounced when the market institution is more developed in both the acquiring firm region and the target firm region. These results confirm our observation that, in the context of the Chinese real estate industry, private firms often suffer from resource constraints in a transitional economy. Further, in the Chinese real estate industry, when SOEs are more accessible to lands facilitated by abundant financial support from the government and the state-owned banks, POEs may seek M&As as an alternative to overcome the resource constraints and to expand the business.

Our study is based upon previous findings that private ownership generally outperforms state ownership (e.g., Megginson, 2005; Park et al., 2006). We applied the rationale to firm post-M&A performance. Firm ownership type not only influences overall firm performance, but also post-M&A performance. In addition, we emphasized the important impact of regional institutional environment in the transitional economy.

Our study suggests that the post-M&A performance difference between POEs and SOEs is the greatest when both the acquiring firm and the target firm

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are in regions of more market-oriented regional institutional environment. We viewed China as a natural lab of heterogeneous institutional environment across regions and investigated how the diversifying institutional environment affects the M&A performance of firms. We examined both the acquiring and target firms' institutional environment, not only considering the impact from the external environment but also the cultural and administrative proximity between the acquiring and target firms. The present study enriches institutional theory by providing evidence on how the heterogeneity of the institutions affects firm behavior in M&A activities and their pathways to growth. Consistent with the previous subnational institution research of foreign investment strategies (Chan, Makino, & Isobe, 2010; Meyer & Nguyen, 2005), we found that the diverse institutions cross regions do matter even when M&A transactions occurred only between local firms. Furthermore, our study recognizes that both home and host market institutions affect the acquiring firm's M&A performance, where previous studies mostly focused on the host market institutions. We contributed to the growing related literature by presenting the interactive effect of firm ownership and subnational institutions.

Limitations and Future Research Directions

There are several limitations of the present study. First, we followed the convention to use the type of actual controller as the criterion to define ownership status. However, ownership structure of firms in China has become more complicated, and even minor state ownership existing in private firms may have significant impact on firm behavior (Tian & Estrin, 2008; Vaaler & Schrage, 2009). Second, although controlling for the ownership of target firms, we still lack detailed information about nonlisted target firms, and target firms' participation in post-M&A decision-making and process is not evident. Third, post-M&A integrations such as retention of top management team, financial evaluation, due diligence, conversion of information system, human resources integration, and sales and product integration are all important aspects to analyze post-M&A performance (Appelbaum et al., 2000), but they are not covered in the present study due to the scope of the research question and availability of data.

In lieu of the limitations, future research may extend the investigation to the circumstances of mix ownership and residual state shareholding of firms and incorporate post-M&A decision-making, process, and integration into the analytic framework. In addition, the interactive impact of ownership and subnational institutions can be generalized to other cross-region strategic actions, and other institutional indicators, such as bank loans for private business and law enforcement efficiency (Allen et al., 2005), can be specifically analyzed to enrich the understanding of institutional environment.

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Practical Implications

The findings from the study have some practical implications. They suggest that the market-oriented environment may help POEs to secure important resources in China's transitional economy. Therefore, based on the findings of the study, in order to develop the private sector, the government in transitional economies should take measures to improve the market environment, such as reducing interference in firm operations, encouraging nonstate investment, and raising the degree of marketization. As shown by the study, private ownership will eventually demonstrate its advantage over state ownership, should it be granted an equitable market environment.

This study answers the question of how POEs in a transitional economy have grown rapidly in a resource-constrained environment. We suggested that M&As could become an important alternative way for POEs in the Chinese transitional economy to overcome the resource constraints and grow. In an underdeveloped market institution, resource allocation to firms is not efficient or effective. Corporate managers in such an environment might concentrate on M&A activities in order to obtain rare resources and grow. Government policy makers in the transitional economy might generate policies that facilitate the transactions of M&As to consolidate resources and encourage the growth of POEs.

Our research sheds light on different types of transactions in a transitional market according to the diverse institutional environments. In order to adapt to the institutional environment, firms might want to choose relevant strategies, such as M&A, strategic alliances, or others. Furthermore, the choices of firm strategies may aggregately shape the institutional development in the transitional economy, particularly in such a diversified institutional environment at the regional level in China.

CONCLUSION

The present study is motivated by the phenomenon in China's transitional economy that private enterprises suffer constraints in key resources while having governance advantages against SOEs. Focusing on the M&A context and the real estate industry, the study reveals that POEs do excel SOEs in post-M&A performance, should the institutional environment be market oriented and favorable to POEs. The findings suggest that the disadvantaged private sector may seek M&A as an alternative growth path to bypass resource constraints and realize its competitive advantages; however, the attempt can only be achieved in a healthy market environment. Hence, the study calls for further attention from both academia and policy makers to the interplay of ownership and subnational institutional context in China's transitional economy. While the private sector has become a substantial economic growth engine in China, its status still falls short of optimal establishment and demands substantial institutional improvement to secure

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its further development and contribution to the advancement of the national economy.

SUPPLEMENTARY MATERIAL

To view supplementary material for this article, please visit http://dx.doi.org/10.1017/mor.2015.30

NOTE

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