

Portability of firm corporate governance in Mergers and Acquisitions

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Abstract

This paper studies the corporate governance portability from bidders to targets in Mergers and Acquisitions and its impact on the bidder announcement returns. We find that the bidder's cumulative abnormal returns are higher in acquisitions where the bidder's corporate governance quality exceeds that of the target. This result suggests a positive valuation effect for bidder shareholders resulting from the portability of good firm corporate governance from the bidder to the target. We also find that this effect is stronger in cross-border deals and when bidders are domiciled in countries with better corporate governance. The results pass several robustness tests, including alternative measures of firm corporate governance and different sample periods.

Keywords: Firm corporate governance; mergers and acquisitions; corporate governance portability; M&A announcement returns.

JEL codes: G30, G34.

1. Introduction

An important stream of the existing literature on the benefits of good corporate governance focuses on the portability of governance standards from bidders to targets (Ellis, Moeller, Schlingemann, and Stulz, 2017; Martynova and Renneboog, 2008; Wang and Xie, 2009). These studies accentuate the idea of “transferability of corporate governance” to illustrate the benefits that acquirer firms, particularly those from countries with better governance standards, achieve after acquiring targets from countries with weaker corporate governance. In short, such benefits are obtained from the enhancements in the target’s corporate governance standards post-acquisition. The new institutional environment can better protect shareholder rights and impose more rigorous accounting disclosure requirements, enhancing the target’s assets market value under the bidder’s management supervision.¹ This study examines whether firm corporate governance is portable and affects the bidder announcement returns in mergers and acquisitions (M&As).

The extant literature that addresses the corporate governance gap between bidders and targets focuses mainly on country-level differences in their governance standards (Bris and Cabolis, 2008; Masulis, Wang, and Xie, 2007; Rossi and Volpin, 2004). However, within each country, there is still considerable heterogeneity in corporate governance quality at the firm level (Klapper and Love, 2004; Martynova and Renneboog, 2008; Starks and Wei, 2013). Several provisions in investor protection laws and other country-level governance mechanisms may not be binding. Companies have the freedom in their company charters to either adopt or reject specific provisions mentioned in their legal codes (Black and Gilson, 1998). Besides the legally required governance attributes², firms can voluntarily adopt more stringent governance practices, which Chhaochharia and Laeven (2009) have shown to be rewarded with higher firm market value.³

As the quality of corporate governance varies across countries and firms, a majority or a full takeover⁴ automatically subjects the target firm to the acquirer’s governance practices. Targets with

¹ In an M&A deal characterized by a change in control, the bidder’s better governance will be applied to the target’s weaker governance (Wang and Xie, 2009).

² Aktas, Croci, and Simsir (2016) provide a comprehensive review of the literature on how internal (board of directors, executive compensation) and external (blockholders, takeover market, product market competition, labor market, and financial market) governance mechanisms affect the M&A process and outcomes. Considering internal governance mechanisms, the authors conclude that the board of directors, through its monitoring and advisory roles, lead to more value-enhancing M&As.

³ For instance, Alexandridis, Antypas, and Travlos (2017) argue that firms improved both mandatory and voluntary corporate governance mechanisms to increase their market value and convey more confidence to the general public in the post-financial crisis period.

⁴ The takeover value increases due to control of target resources under the bidder’s possession, and the bidder uses them efficiently.

weaker governance standards pre-acquisition can benefit post-acquisition from a transfer of good governance practices when acquired by a bidder with better corporate governance quality and, by doing so, uplift its persona of a well-managed firm. Better managed bidders can more effectively scrutinize the target firm as they have better-qualified management. Thus, the portability effect is not merely confined to country-level governance but can also result from a more pervasive shift in firm corporate governance to enhance the acquisition value.

M&A deals provide the appropriate setting to understand the portability of firm-specific governance standards among firms and its economic impact. Previous studies on portability/spillover effects of corporate governance focus on cross-border mergers and acquisitions (M&A) and country-level governance gaps. In contrast, this study contributes to the literature by analyzing whether firm-level corporate governance attributes are portable from bidders to targets and affect the bidder's value created by the acquisition. In the spirit of the portability theory developed by Ellis et al. (2017), we examine whether, *ceteris paribus*, the bidder's cumulative abnormal returns are higher when the firm-level corporate governance gap between bidder and target is higher (i.e., the better quality of bidder's governance relative to the target). This research adopts an agency perspective of the company and discusses the value creation of M&As from the lens of firm corporate governance.

We measure the corporate governance gap between bidders and targets based on four firm-level governance indices: board structure index, board function index, compensation policy index, and shareholder rights index.⁵ Using a sample of 1026 domestic and cross-border deals from 2003 to 2016, we find that the abnormal bidder returns around M&A announcements are significantly higher when the bidder-target corporate governance gap is higher.⁶ The results hold after controlling for several firms- and deal-level characteristics, country-level corporate governance gap, and macro-economic variables. Our result supports the idea that corporate governance is portable from the bidder to the target and suggests that one possible source of higher bidder gains from M&As is the improvement in the target's governance standards affected by the change in control. It also echoes the argument of Hartzell, Ofek, and Yermack (2004) that target managers usually do not possess enough incentives to change their firms' corporate governance voluntarily. This incentive problem is solved in M&As where better-governed bidders make side payments to target managers for giving up control and, therefore, improve the overall quality of the firms' corporate governance.

⁵ We observe considerable cross-sectional variation in governance quality of bidders and targets.

⁶ Recently, the ASSET4 ESG updated the data, and our results still hold if we use new categories of corporate governance. The results are shown in the Internet Appendix.

We next investigate if the uncovered portability effect is higher in cross-border or domestic deals as the empirical evidence reveals a high degree of variation in firm-level governance in cross-border deals (Martynova and Renneboog, 2008). Therefore, we split the sample into domestic and cross-border deals. Our global sample of M&As enables us to analyze the impact of the gap in firm-level governance between bidders and targets in cross-border and domestic deals worldwide. Our results show that the portability effect in cross-border deals is higher than in domestic deals. This result reveals that there is significantly higher variation in firm corporate governance across countries and that the weaker governance of target firms is a source of higher bidder returns.

Further, we examine in which countries⁷ the portability effect is more effective and more valued by the market in M&As. It is expected that bidder-target portability will be more appreciated in countries with better country governance, first because in those countries investors value more good governance (Ellis et al., 2017; Klapper and Love, 2004), and second because the good quality of the country institutions helps make the transfer of good governance more effective (Martynova and Renneboog, 2008). We use World Governance Indicators issued by the World Bank and the anti-self-dealing index (ASDI) proposed by Djankov, La Porta, Lopez-de-Silanes, and Shleifer (2008) to proxy for the country's institutional quality. Following Kaufmann, Kraay, and Mastruzzi (2009), we compute the mean index, named world governance index (WGI), based on six indicators for each country. To identify better-governed countries, we create a binary variable that equals one if the index is above the world median and zero otherwise. We find that the portability effect is more substantial in countries with better country-level corporate governance, proposing that firms can have good governance mechanisms, but the country has to have adequate enforcement for those mechanisms to be efficient.

Despite the voluminous literature on M&As to date, we know very little about the effect of firm-level corporate governance portability from bidders to targets on the value created by bidder firms. We contribute to the literature showing that when bidders with better corporate governance acquire poorly governed targets, the bidder gains are more significant. We extend the portability theory of Ellis et al. (2017) and show that beyond the country-level governance, firm-specific corporate governance can also be transferred through the acquisition channel and improve the management quality of a relatively weaker target firm. Our work also contributes to the M&As

⁷ For instance, Klapper and Love (2004) find that average firm corporate governance is lower in nations having weaker legal systems. Similarly, Doidge, Karolyi, and Stulz (2007) document that, in less developed countries, country characteristics elaborate more of the international corporate governance ratings than firm-level characteristics.

literature that relates value-enhancing takeovers with reduced agency costs in the 1980s and 1990s (for example, Bradley, Desai, and Kim, 1988; Loderer and Martin, 1990). Our results show that takeovers of the 2000s and 2010s also create efficiency gains in the same way through firm corporate governance transfers from bidders to targets. Finally, we contribute to the literature of cross-border acquisitions and corporate governance quality (e.g., Ellis et al., 2017; Kim and Ozdemir, 2014; Zattoni, Dedoulis, Leventis, and Ees, 2020) by showing that the portability of firm level corporate governance is amplified when bidders are domiciled in countries with better shareholder protection.

We arrange the remainder of the study as follows: Section 2 reviews the literature and develops the hypothesis; Section 3 describes the data and shows summary statistics; Section 4 describes the methodology; Section 5 discusses our main results; Section 6 presents robustness tests; Section 7 shows portability effect in better-governed countries; Section 8 concludes.

2. Literature review and Hypothesis Development

The effect of firm corporate governance on M&A outcomes has been previously studied. For example, Cotter, Shivdasani, and Zenner (1997), Datta, Iskandar-Datta, and Raman (2001), Masulis, Wang, and Xie (2007), and Moeller, Schlingemann, and Stulz (2005) with the main results being that bidders with better corporate governance have relatively higher announcement returns and tend to overpay less for their targets. The manager-shareholder incentive-alignment mechanisms exist in companies with better corporate governance and motivate managers to pursue value-creating deals, better estimate the synergies and pay a fairer premium.

If an acquisition of two publicly traded companies is not anticipated, the value created through the deal should be reflected in the announcement returns. The empirical literature shows that, on average, M&As generate wealth as a whole (see, among others, Bradley, Desai, and Kim, 1988; Mulherin and Boone, 2000; Servaes, 1991; Wang and Xie, 2009), although asymmetrically distributed between bidders and targets. Target stockholders tend to capture the largest share of the combined returns (Malatesta, 1983), while bidders typically experience minor gains (Andrade et al., 2001) or even higher losses (Moeller, Schlingemann, and Stulz, 2004).

When the quality of the bidder's corporate governance is better than that of the target, the superior management quality of the first can be exported to the latter. Thus, after the acquisition, the target assets will be under better-qualified management. This transferability (or portability) of firm corporate governance will enable the bidder to manage better target resources, a source of higher gains. Prior studies on the portability of corporate governance address cross-country differences in

shareholder protection rights and country-level institutional quality (Ellis et al., 2017; Martynova and Renneboog, 2008). This fast-growing strand of literature documents that bidders from countries with better corporate governance can export their governance standards when they acquire targets from countries with weaker corporate governance. This portability effect translates into greater takeover returns accruing to M&As where the corporate governance gap between the bidder country and the target country is larger (see, for instance, Bris and Cabolis, 2008; Rossi and Volpin, 2004).

The quality of corporate governance is partially determined by the level of shareholder protection and the country's institutional quality where the firm is domiciled. Nonetheless, there is enough variation in corporate governance quality among firms from the same country (Starks and Wei, 2013). Besides the country-level corporate governance standards, firms implement their monitoring mechanisms of managerial activities with different efficiency degrees. Some recent studies use ASSET4 ESG scores as proxies for firm corporate governance and find that higher governance scores are positively associated with higher market valuation and performance (e.g., Doung, Kang, and Salter, 2015; Guney, Hernandez-perdomo, and Rocco, 2019; Tarmuji, Maelah, and Tarmuji, 2016). We do not find empirical evidence relating to M&A deals (both cross-border and domestic) outcome with the firm-level corporate governance gap between the bidder and the target in the global sample. In this paper, our purpose is to fill this gap by testing whether the portability of corporate governance enhances the bidder returns. Building upon these ideas, we formulate the main hypothesis of this study as follows:

A higher firm corporate governance gap between the bidder and the target (bidder minus target) is associated with higher bidder announcement returns, ceteris paribus.

Throughout the paper, we explore several variations of the main hypothesis. For instance, we test whether the transfer of corporate governance from bidders to targets are more effective and yield higher returns either in samples of cross-border or domestic acquisitions.

3. Data and summary statistics

We use various sources to assemble the panel of companies involved in mergers and acquisitions around the world. The sample of mergers and acquisitions is from Securities Data Corporation (SDC) database. Our sample comprises 649 domestic M&As and 377 cross-border M&As between 2003 and 2016 from 15 countries. Both acquirers and targets are publicly traded companies with stock price data from the Thomson Reuter's DataStream database. Firm-level corporate governance data are from the ASSET4 ESG database. The sample excludes financials (SIC

codes 6000-6999) and utilities (SIC codes 4900-4949). We require that bidders have less than 50% of the target shares before the deal and end up with a controlling position on the target equity post-acquisition.⁸ Since a small number of deals can add noise in the analysis, countries with less than five deals during the sample period are dropped.

Table 1 shows the country distribution of bidder firms and deals around the world. The most active nations in the international market of mergers and acquisitions are the United States⁹, Japan, and Canada. These three countries represent 67% of the global sample of M&As. The United States dominates the takeover market, with 133 bidders involved in 298 (domestic and cross-border) M&A deals. The total number of firms engaged in domestic M&A activity from the leading countries exceeds their cross-border M&As. Our global acquisitions sample shows 591 bidding firms involved in 649 domestic deals and 377 cross-border deals. It is well documented that mergers and acquisitions appear in waves and clusters by industry. We observe the highest dollar value of M&A activity in the year 2005 (see figure 1). The number of M&A deals has been steadily increasing from 2003 to 2005 and reached its peak in 2005, a significant decline in M&A activity during the world crisis in 2008, and a revival in 2009. This trend of M&A deals is similar, as reported by Wang and Xie (2009) and Moeller, Schlingemann, and Stulz (2004).

Table 2 shows summary statistics of involved variables, and we find substantial dispersion in our sample for all variables. Panel A of Table 2 reports that the average bidder's 5-day cumulative abnormal return is 2.3%, consistent with studies that say that M&As create positive returns for bidder shareholders (Alexandridis, Antypas, and Travlos, 2017; Martynova and Renneboog, 2008). Panel B of Table 2 shows the differences in firm corporate governance in four indices. The primary firm corporate governance indices we focus on are the board structure index, board function index, compensation policy index, and shareholder rights index. The differences in these indices can take values from -60 to +76. We report that firm governance differences vary from 47.51 to 53.31 at the median, but their standard deviations are quite large. The bidder governance indices are higher than the target indices, and subsequently, differences in all indices are higher. Panel C of Table 2 states that the average bidder's WGI gap is 7.24, while average GDP growth and GDP per capita are 1.93 and 10.66, respectively. Panel D of Table 2 presents dummy variables for same-industry deals, deals paid in cash, cross-border deals, and relative size. Mostly, public acquirers pay in cash (55.5%), and

⁸ We find similar results using 100% ownership acquisitions.

⁹ Although the US dominates our sample, the results for portability of firm corporate governance still hold when we drop deals made by the US bidders.

the remaining payments in stock (44.5%); almost 37% of acquirers engaged in cross-border deals while remaining in domestic deals. Deals among the same industries accounted for 37.8%. The bidder attributes that we consider are leverage, Tobin's Q, size, and stock price run-up. All of them are measured at the end of a year before an acquisition. Panel E of Table 2 Presents that mean values for bidder leverage, Tobin's Q, size, run-up are 0.22, 0.53, 15.91, 0.005, respectively. The definitions of all variables are in Appendix A and Appendix B.

A concern with the several firm characteristics is that they might be strongly correlated. To check it for our sample, we present the correlation matrix for involved variables in Table 3. The first column provides the correlation of the bidder returns with all variables, and the second column shows the correlation of the board structure gap with other variables. Not surprisingly, the board structure gap is strongly correlated with gaps in other firm corporate governance mechanisms. We show that the firm governance gap in our governance indices is positively correlated with the bidder returns.

4. Methodology

4.1 Cumulative abnormal returns

If an acquisition involving public companies is not anticipated, the deal's value can be captured by the announcement returns. Under our central hypothesis, we postulate that firm governance's portability should have a positive effect on bidder cumulative abnormal returns. We estimate expected returns using the following market model:

$$R_{ijt} = \alpha_{ij} + \beta_{ij}R_{jt} + \varepsilon_{ijt}, t = -255, \dots, -25, \quad (1)$$

where R_{ijt} is the daily stock return for bidder firm i in country j ; R_{jt} is the DataStream daily market index return for country j ; ε_{ijt} is the bidder's excess return. Fama, Fisher, Jensen, and Roll, (1969) standard event study methodology is used to calculate cumulative abnormal returns (as the difference between expected and realized daily returns) for 5 days period ($t-2, t+2$) around the announcement date. We use the following model to test our hypothesis:

$$\begin{aligned} Bidder\ CAR\ (-2, +2)_{d,t} = & \alpha + \beta_1 CG\ GAP_{d,k,t-1} + \beta_2 Country\ controls_{j,t-1} + \\ & \sum \beta_m Deal\ controls_{d,t} + \sum \beta_n Firm\ controls_{i,t-1} + \\ & \lambda_k + \eta_j + \gamma_t + \varepsilon_{i,t} \end{aligned} \quad (2)$$

where *Bidder CAR* $(-2, +2)_{d,t}$ is the bidder's cumulative abnormal return around the announcement date of deal d at time t over the 5-days event window; α is the intercept; *CG GAP* $P_{d,j,t-1}$ is the corporate governance score of the bidder's index minus the corporate governance score of the target's index for deal d , industry k , one year before the deal announcement. *Country controls* $s_{j,t-1}$ is a vector of country-specific controls for the country j one year prior to the deal and it includes: WGI gap¹⁰, Gross Domestic Product (GDP) growth, and log GDP per capita; *Deal controls* $s_{d,t}$ is a vector of deal-specific controls for deal d and year t ; *Firm controls* $s_{i,t-1}$ is a vector of firm-specific controls for bidder/target firm one year prior to the deal. The deal specific-controls include: payment method, a dummy variable that is equal to one if the deal is paid by cash and zero otherwise; cross-border deal, an indicator variable that equals one for cross-border deals and zero otherwise; same industry deal, a dummy variable that is equal to one if the bidder and the target belong to the same industry and zero otherwise; relative deal size, deal-value scaled by the bidder market value of equity. The firm specific-controls of bidders include leverage, long-term debt divided by total assets; Tobin's q , total assets minus book value of equity plus the market value of equity divided by total assets; size, the log of the book value of total assets; stock price run-up, the sum of abnormal returns using the market model for a window of 90 days up to 20 days before deal announcement. We also add dummies to control for industry, λ_k , country, η_j , and year, γ_t . Further, Fama-French 48 industry categories are used for the bidder's industry fixed effects. Finally, we mitigate the outlier's effect by winsorizing firm-specific controls and bidder CARs at the top and bottom 1% of the distribution.

4.2 Corporate governance indices

The key independent variables are based on the corporate governance scores of four firm governance mechanisms: board structure (effective participation of independent directors), board function (guarantee that corporate governance principles are applied), compensation policy (guarantee incentive alignment and independent compensation designs), and shareholder rights (guarantee that minority shareholders are protected). Our choice is driven by the fact that the quality of the bidder's firm corporate governance can be transferred to a target with weaker quality of firm corporate governance. Data on these firm-level governance mechanisms are from the ASSET4 ESG database. This database rates firms on 250 key performance indicators grouped into four major categories of performance: social, corporate governance, environmental, and economic. It allocates a

¹⁰ This is lagged difference in WGI between the bidder and the target countries.

percentage score based on many factors to each of the below-mentioned classes. ASSET4 ESG uses data from the company's regulatory filings and annual reports to calibrate governance scores. This study focuses on the corporate governance pillar that measures a firm's processes to ensure that its executives and board members work in their shareholder's best interests. This pillar is divided into the following categories:

(1) Board function – measures a firm's management dedication and effectiveness towards obeying the best corporate governance principles associated with board functions and activities. This indicates a firm's potential to have a useful board by formulating important board committees with assigned responsibilities and tasks.

(2) Board structure – measures a firm's management dedication and effectiveness towards obeying the best corporate governance principles associated with well-balanced membership of the board. It reveals a firm's potential to safeguard the exchange of constructive and critical ideas and an effective decision-making process through an independent, diverse, and experienced board.

(3) Compensation policy – measures a firm's management dedication and effectiveness towards making compensation policies for managers. It elaborates how the managers are compensated both financially and non-financially.

(4) Shareholder rights – measures a firm's management commitment and effectiveness toward defining and protecting the shareholder's rights. It reflects whether the minority shareholders have the same rights as concentrated shareholders or not?

Since our research design is based on firm-level governance's relative strength, we use collective measures to capture the relative quality of each governance mechanism. We use 55 individual governance variables,¹¹ and each governance variable has a score from 0 (lowest) to 100 (highest). We construct four corporate governance indices¹² based on the categories mentioned above for both bidders and targets. To measure the gap in firm corporate governance between the bidder and the target, we calculate each governance index's lagged average score for both bidder and target at the end of the year before an acquisition. The gap is calculated as the bidder's index minus the target's index. A positive gap means that the bidder has a better quality of corporate governance than the target. The higher the gap, the more efficiently the bidder can use the target's assets to enhance

¹¹ Definitions of all these individual governance variables are given in Appendix B.

¹² These indices are time-varying and capture a gap in governance quality between bidders and targets. Each governance index is calculated by summing up scores of all governance variables in a category provided by ASSET4 ESG and dividing by the number of variables.

the acquisition's value. Measuring the bidder-target gap in these different dimensions allows us better to understand the scope of corporate governance portability in M&As.

4.3 Control variables

We consider three groups of variables associated with bidder returns: country characteristics, deal characteristics, and bidder firm characteristics.¹³

The country characteristics that we control for include bidder-target country governance gap, Gross Domestic Product (GDP) growth, and GDP per capita, all of which are measured one year before the deal announcement. The studies on country-level governance find evidence that a higher difference in country governance between bidders and targets generates positive returns to bidders (Ellis et al., 2017; Martynova and Renneboog, 2008). To control financial development and economic growth, we follow Fauver, Loureiro, and Taboada (2017) and use the log of GDP per capita and GDP growth.

We control the deal-specific characteristics for payment method, cross-border deals, whether the bidder and the target are from the same industry, and relative deal size. It is well established that acquirers earn significantly lower returns when they finance the deal with equity due to the adverse selection problem mentioned by Myers and Majluf (1984). The bidder's cash payment would positively impact announcement returns (Shleifer and Vishny 2002; Graham, Lemmon, and Wolf, 2002), and bidders can earn higher returns when they pay with cash. We classify the same industry acquisition if the bidder and the target share a Fama-French industry. Morck, Shleifer, and Vishny (1990) show that diversifying acquisitions are value-destructive for bidder shareholders and wealth increasing for self-interested managers. The M&As of related businesses can create higher returns due to cost-saving through economies of scale (Masulis, Wang, and Xie, 2007). The studies on diversification discount (Campa and Kedia, 2002; Villalonga, 2004) find that diversifying acquisitions are not necessarily linked with lower firm value, but sometimes they increase firm value. Therefore, the net effect of diversifying acquisitions on bidder CARs is obscure. Some studies show that cross-border deals are value-enhancing for bidder shareholders (see Ellis et al., 2017; Martynova and Renneboog, 2008). We also consider relative deal size as papers by Asquith (1983) and Moeller, Schlingemann, and Stulz (2004) show that the relative deal size positively affects bidder returns.

¹³ For a review on the determinants of M&As and their wealth effects, see, for example, Martynova and Renneboog (2008) and Jensen and Ruback (1983).

We control some bidder characteristics, including leverage, Tobin's q, and size, all of them are measured one year prior to the deal announcement. Leverage plays an important governance role in limiting managerial discretion because higher debt decreases future cash flows (Lang, Stulz, and Walkling, 1991). It provides incentives for managers to increase firm performance to keep their jobs alive (Gilson, 1990) and is associated with takeover protection (Garvey and Hanka, 1999). The effect of Tobin's q on returns is ambiguous, according to the existing studies. Lang, Stulz, and Walkling (1989) show that bidder returns increase with the bidder's Tobin's q and decrease with the target's Tobin's q, while Wang and Xie (2009) do not find any relation between bidder returns and Tobin's q of the bidder. Moeller, Schlingemann, and Stulz (2004) document the bidder size's negative effect on the returns as larger bidders pay higher premiums. We finally control for the pre-deal bidder stock price run-up using an event window of 90-day to 20-day before the deal's announcement.

5. Portability of firm corporate governance

5.1 Main results

To test this study's central hypothesis, we estimate cross-sectional regressions of bidder CARs on differences in four governance indices and a set of control variables. The results are reported in Table 4. In Models 1 to 8, we show the effect of portability of firm corporate governance on bidder CARs using the bidder-target gap in four firm-level governance indices: the difference in board structure index, the difference in board function index, the difference in compensation policy index, and the difference in shareholder rights index, respectively. As shown in Table 3, differences in firm-level governance mechanisms are highly correlated, so that multicollinearity can make it difficult to examine the impact of firm governance in multiple regressions. To tackle this problem, we estimate regressions with the difference in one firm governance index at a time to gauge the strength of the relation between bidder announcement returns and firm corporate governance indices. We first include only the bidder-target governance gap as the key explanatory variables. The estimated coefficients on the governance gap indices are positive and statistically significant. The results are also economically significant. A one standard deviation increase in the bidder-target governance gap in terms of board structure, board function, compensation policy, shareholder rights increase bidder announcement returns by 0.75¹⁴, 0.84, 0.77, 0.74 percentage points (pp), respectively.

¹⁴ Considering Model (1) in Table 4, the coefficient on governance gap in board structure is 0.0003 (t-statistic of 4.025) with 25.255 standard deviation. So, an increase of one standard deviation in board structure gap increases bidder CARs by 0.75 percentage points (Standard deviation \times β coefficient \times 100 = 25.255 \times 0.0003 \times 100 = 0.75).

In Models 5 to 8 of Table 4, we add all independent variables and estimate the effect of firm corporate governance gap on bidder CARs. The parameter estimates show that the bidder-target corporate governance gaps positively and significantly affect the bidder announcement returns. The economic magnitudes of the portability effect are almost same as reported previously. The results are consistent with our hypothesis - for all of the firm governance indices, we find that the bidder CARs increase in firms with a higher firm corporate governance gap. It means that the gains to bidder shareholders are higher in M&As when the target firm has poor governance. It further suggests that one potential source of higher bidder gains from M&As is improving the target's governance standards due to change in control. Based on our results, we argue that higher firm-level governance benefits are portable from the bidder to the target. The target shareholders can enjoy the benefits of the good governance of the bidder. Our results are in accordance with recent studies that document positive bidder returns resulting from the portability of country governance (see, for example, Ellis et al., 2017; Martynova and Renneboog, 2008).

The regression models include a set of control variables that have been suggested in the existing literature. The coefficients of control variables are similar in magnitude and statistical significance across the four model specifications (Model 5 to 8) in Table 4. Most of the coefficients of controls are qualitatively similar to what other studies report (Masulis, Wang, and Xie, 2007; Moeller, Schlingemann, and Stulz, 2005; Wang and Xie, 2009). More importantly, we find that cross-border dummy, bidder size, and GDP per capita has a negative effect on bidder CARs.

Overall, we find that firm corporate governance is portable from bidders to targets in M&As, and the bidder shareholders earn higher returns as the bidder-target governance gap increases. These results still hold after including year, industry, and country fixed effects, using alternative firm governance measures, and testing different sample periods. The results contribute to the portability theory of Ellis et al. (2017), showing that country-level governance and firm-level governance can be exported from bidders to targets through M&As.

5.2. Cross-border versus Domestic deals

Next, we do an additional analysis to provide evidence on two different subsamples – cross-border versus domestic deals. We investigate if the uncovered portability effect is higher in cross-border deals than domestic deals. The expansion through cross-border mergers and acquisitions (M&As) allows firms to get additional rents due to market inefficiencies and different tax systems (Servaes and Zenner, 1994). For instance, Col (2017) examines tax-motivated M&As and finds that

tax benefits, associated with tax haven jurisdictions, may motivate some cross-border acquisitions, although at the cost of exposing firms to weaker corporate governance environments. Another source of increasing takeover value in cross-border M&As can be persuaded by enhancements in poorly managed firm's corporate governance by well-managed firms due to portability of corporate governance standards (Martynova and Renneboog, 2008; Ellis et al., 2017). Relatively few studies explore the effect of firm-level governance difference on takeover returns, the notable exception being Wang and Xie (2009). They use the corporate governance index made by Gompers, Ishii, and Metrick (2003) to measure shareholder rights and show that target firms benefit from bidder's higher firm-level shareholder rights in domestic U.S. mergers and acquisitions. This study presents evidence of the variation in corporate governance standards between bidders and targets within the same country (the U.S.). However, the scope for potential improvements in governance standards is even higher in cross-border deals (Martynova and Renneboog, 2008) because significant differences in governance standards amplify the gap between the acquirer and target governance.

Our global sample enables us to identify the effect of a gap in firm-level governance separately for cross-border and domestic deals; therefore, we separate cross-border deals from domestic deals in Table 6 and test our models. We use the cross-border sample of M&As in Models (1) to (4) of Table 5. In these regressions, we control for the same variables as in Table 4. The coefficient of interest here is the bidder-target firm governance gap. We find that the governance gap has a significantly positive effect on bidder returns¹⁵ and suggests that cross-border deals are value-enhancing for bidder firms. Our results for the bidder returns support the hypothesis that portability has valuation effects for cross-border deals. Nevertheless, there are some competing explanations for these results. First, it is well documented that several frictions and costs are related to the acquisition process and post-acquisition integration (Erel, Liao, and Weisbach, 2012; Fama and Jensen, 1983; La Porta, Lopez-de-Silanes, Shleifer, and Vishny, 1998; Rajagopalan and Finkelstein, 1992). Considering the higher costs related to cross-border deals, the benefits of applying higher governance standards of the target can outweigh their costs for the targets. Given the portability effect of cross-border deals, the target firms can benefit from the bidder's higher governance standards. Second, the cross-border deals are accessible to firms from several nations, and therefore the price of such deals is set internationally (Ellis et al., 2017). Thus, cross-border deals generate higher gains than domestic deals (Martynova and Renneboog, 2008). Third and perhaps most importantly, there is more

¹⁵ For example, in Model (1), one standard deviation increase in the board structure gap increases bidder CARs by 1.01 percentage points ($0.0004 \times 25.255 \times 100$).

heterogeneity in firm governance mechanisms when firms engage in cross-border deals than domestic deals.

We next run similar regressions for domestic deals in Models (5) to (8) of Table 5. In these models, we use bidder's country governance instead of the country-level governance difference between bidder and target. Our results show that the governance gap has a positive and statistically significant effect on bidder CARs. However, the economic magnitudes are lower and statistically less precise than in cross-border deals. The reason behind comparatively weaker portability effects on the bidder CARs in domestic deals can be lower variation in firm governance standards or lower potential improvements in governance than cross-border deals. Our results show that the portability effect in cross-border deals is higher than in domestic deals mainly because of significant variation in firm corporate governance across the countries than within countries.

6. Robustness tests

This section examines the robustness of the positive impact of corporate governance portability on bidder CARs documented above. The results are also robust when we use the following alternative specifications of our models: (1) we measure bidder cumulative abnormal returns over 11-day event window and results are in Panel A of Table 6; (2) in Panel B of Table 6, we construct an overall index (Model 1) based on four governance indices used in the study; PCA index (Model 2) using the principal component analysis to construct average governance score of the bidder and the target, we retain the first component having the Eigenvalue of greater than one and calculate the governance difference by subtracting PCA index score of the target from the PCA index score of the bidder; also develop governance indices based on widely discussed attributes in the literature; the results remain qualitatively unchanged; (3) mergers and acquisitions happen in waves and clusters in industries and mainly they cluster in time (Martinez-Blasco and Garcia-blandon, 2017), In Panel C of Table 6, we examine the portability effect over two periods of time and test whether our findings are driven by acquisitions clustering within a specific time period, we re-estimate models in Table 4 on subsamples of takeovers from 2003 to 2009 (494 transactions) and from 2010 to 2016 (532 transactions) respectively, the gap in firm corporate governance has a positive effect on bidder returns in each subsample regression. Thus, all results are consistent with prior evidence that well-managed bidder's acquisitions of poorly-managed targets generate higher bidder returns.

7. Portability of firm governance and country governance

We now examine whether the portability effect is different in M&As depending on the bidder country governance. Referring to the legal, political, regulatory, and economic frameworks of a country that enforce laws and property rights, institutions are deemed to be an important determinant of the way of doing business (Salomon and Wu, 2012). Kim and Ozdemir (2014) show that external governance mechanisms (investor protection, the rule of law, and open markets institution) change the costs and benefits of board structure choices, suggesting that firms alter their boards according to the institutional environment. Zattoni et al. (2020) examine the effect of institutional quality on firm-level corporate governance (ownership structure, the board of directors, executive compensation, CEO) and firm outcomes (capital structure, earnings management, operating performance); they find that better institutional quality protects investors and is positively linked with better governance standards and firm outcomes. Many studies investigate the interaction between country-level and firm-level governance (Aggarwal, Erel, Williamson, and Stulz, 2009; Klapper and Love, 2004) and find a positive correlation. Therefore, we would expect that the portability effect is more likely to create higher bidder CARs when the bidder is domiciled in a better-governed country. This is because investors value more good governance standards in these countries (Ellis et al., 2017; Klapper and Love, 2004). The better quality of country institutions helps make the portability of better governance more effective (Martynova and Renneboog, 2008). Based on these arguments, the portability effect should be higher when the bidder is from a better-governed country. To test this, we use the following model:

$$\begin{aligned}
Bidder\ CAR(-2, +2)_{d,t} = & \alpha + \beta_1 CG\ GAP_{d,k,t-1} + \beta_2 high\ Country\ gov_{j,t-1} + \beta_3 CG\ GAP_{d,k,t-1} \times \\
& high\ Country\ gov_{j,t-1} + \sum \beta_m Deal\ controls_{dt} + \sum \beta_n Firm\ controls_{i,t-1} + \\
& \sum \beta_q Country\ controls_{j,t-1} + \sum \beta_f FE_{t,k,j} + \varepsilon_{i,t}
\end{aligned} \tag{3}$$

To measure country governance, we use World Governance Indicators issued by the World Bank (see Kaufmann, Kraay, and Mastruzzi, 2009) and the anti-self-dealing index (ASDI) proposed by Djankov et al. (2008). The indicators are time-varying and measure how well a nation overcomes corruption, government effectiveness, regulatory quality, the recognition for the rule of law, the level of political stability, and citizen's freedom to elect a government. Following Kaufmann, Kraay, and Mastruzzi (2009), we compute the mean index (WGI index) based on these six attributes for each country and create a dummy variable based on the WGI index and ASDI. We define better-governed countries if the index is above the world median.

Table 7 estimates cross-sectional regressions of bidder CARs on the same variables included in Table 4 except bidder's WGI index plus an additional variable based on the interaction between firm governance gap and WGI index. Like before, all regressions include year, industry, and country fixed effects. Our variable of interest is the interaction between the bidder-target governance gap and the bidder's WGI index (a proxy for the better-governed countries). Models (1)-(4) test the interaction between the firm governance gap and the WGI index; we find that, on average, the portability effect is positive when the bidder is from a better-governed country. The coefficient on the interaction term [*High bidder WGI* × *B – T governance gap*] is positive and statistically significant in all of the regressions. As far as economic magnitude is concerned, for instance, in Model (1), we observe that on average portability effect is 0.06 percentage points higher when the bidder is from a better-governed country. In Models (5)-(8), the variable of interest is the interaction between the bidder-target governance gap and high bidder ASDI. The results support the view that the portability effect is higher when bidders are from better-governed countries.

Overall, we find evidence that the portability effect is higher when the bidder is domiciled in a country with better governance standards. It is in line with the notion that bidders from better-governed countries make value increasing-acquisitions (Ellis et al., 2017; Martynova and Renneboog, 2008) and suggests that firms may adopt good governance standards, but the country should have adequate enforcement for those standards to be efficient.

8. Conclusion

As predicted by our hypothesis, we demonstrate that the benefits of good firm corporate governance are portable. The bidder returns increase as the firm corporate governance gap between the bidder and the target increases. We focus on four essential aspects of a firm's corporate governance: board structure, board function, compensation policies, and shareholder rights, as a proxy for how well a company is managed. Our results suggest a positive valuation effect from the portability of firm-level governance from the acquirer to the target. The bidder shareholders capture this valuation effect as the effect of the bidder-target corporate governance gap is positive and statistically significant on bidder's announcement returns.

When we dichotomize our sample into domestic and cross-border deals, we find that the portability effect on bidder returns is stronger in cross-border deals. This result suggests that there is more heterogeneity in firm-level governance between the bidder and the target in cross-border deals than domestic deals and weakly governed targets can benefit strongly governed bidders after a

successful acquisition. We also show that the portability of corporate governance interacts positively with country governance in our global sample. It means that the portability effect is stronger in countries with better country-level corporate governance, suggesting that firms can have good governance mechanisms. Still, the country has to have fair enforcement for those mechanisms to be efficient.

Our findings are not due to firm corporate governance, acting as a proxy for country-level governance. In all our regression analyses, we control the country-level governance gap, and our results on the portability of firm corporate governance still hold. Overall, our results suggest that M&A deals with different firm corporate governance standards create higher bidder returns, partly associated with firm corporate governance improvements of targets. Eventually, We can extend the portability theory of Ellis et al. (2017) and show that apart from the country-level governance, firm-specific corporate governance can also be transferred from bidders to targets through M&As.

Our study also offers some relevant policy insights for regulators and policy makers on how a well-functioning market for corporate control, free of inefficient frictions, can be a vehicle for transferring good corporate governance practices between firms, with positive consequences for the market value of firms' equity.

This work is subject to certain limitations that open important avenues for future research. Further research should scrutinize how the returns from M&As are distributed between the acquirer and the target stockholders as a function of the firm corporate governance gap. Our results can stimulate future research to investigate how the bidder-target governance gap affects the success of an M&A deal. We have focused on control-acquisitions, and the work we conducted could be applied to partial acquisitions or joint ventures. Lastly, there is no reliable source of firm-level governance data for private bidders and targets. The study on privately combining firms could lead to the study's extension.

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Table 1: Distribution by the bidder's country

The table shows the sample distribution of control acquisitions per country between 2003 and 2016. The ASSET4ESG database covers both the acquirer and target before an M&A deal. We eliminate countries with less than five deals during the sample period.

Country	No. of bidder firms	No. of domestic deals	No. of cross-border deals
Australia	66	75	19
Canada	101	145	42
Finland	4	1	7
France	34	25	43
Germany	17	5	15
India	7	4	4
Israel	5	2	9
Italy	9	1	11
Japan	135	157	45
Norway	5	3	4
Spain	10	5	7
Sweden	12	3	14
Switzerland	17	7	27
United Kingdom	36	19	29
United States	133	197	101
Total	591	649	377

Table 2: Descriptive statistics

The sample consists of 1026 completed international mergers and acquisitions listed in Securities Data Corporation (SDC) between 2003 and 2016. The ASSET4ESG database covers both the acquirer and target before an M&A deal. The CARs are calculated using the market model for the period (-255, -25). The bidder's CARs are the 5-day cumulative abnormal returns around the announcement date. Other variables are defined in Appendix A and Appendix B.

	N	Mean	Median	S.D.	Min	Max
Panel A: Cumulative abnormal returns						
Bidder CARs	1026	.023	.019	.051	-.198	.267
Panel B: Bidder-target firm governance gap						
Board Structure gap	1026	39.229	47.515	25.255	-67.844	71.855
Board Function gap	1026	40.555	53.311	28.128	-66.201	76.066
Compensation Policy gap	1026	39.672	51.058	25.748	-60.795	71.531
Shareholder Rights gap	1026	43.278	51.468	24.952	-60.436	71.611
Panel C: Country characteristics						
WGI gap	1026	7.243	0	24.329	-42.474	99.756
GDP growth	1026	1.938	2.225	2.04	-5.697	7.996
Log GDP per capita	1026	10.669	10.695	.367	7.005	11.519
Panel D: Deal characteristics						
Payment method (dummy)	1026	.555	1	.497	0	1
Cross-border deal (dummy)	1026	.367	0	.482	0	1
Same industry deal (dummy)	1026	.378	0	.485	0	1
Relative size	1026	.183	.051	.336	0	2.706
Panel E: Bidder characteristics						
Bidder Leverage	1026	.225	.208	.162	0	.917
Bidder Tobin Q	1026	.531	.542	.213	-.084	1.351
Bidder Size	1026	15.913	15.867	1.696	10.347	19.583
Bidder Run up	1026	.005	.001	.182	-.867	.931

Table 3: Correlation Matrix

The sample consists of 1026 completed international mergers and acquisitions listed in Securities Data Corporation (SDC) between 2003 and 2016. The ASSET4ESG database covers both the acquirer and target before an M&A deal. The CARs are calculated using the market model for the period (-255, -25). Bidder CARs are 5-day cumulative abnormal returns around the announcement date. All variables are defined in Appendix A and Appendix B.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)
1	1															
2	0.13***	1														
3	0.10***	0.93***	1													
4	0.11***	0.92***	0.94***	1												
5	0.13***	0.87***	0.84***	0.84***	1											
6	-0.00	-0.00	-0.01	-0.00	-0.00	1										
7	-0.03	0.09**	0.05	0.04	0.12***	0.00	1									
8	-0.09**	-0.03	-0.01	0.00	-0.07*	0.39***	0.13***	1								
9	-0.05	0.06*	0.10**	0.10***	0.00	0.00	-0.21***	0.02	1							
10	0.01	-0.30***	-0.26***	-0.26***	-0.35***	-0.07*	-0.31***	-0.00	0.07*	1						
11	0.00	-0.09**	-0.09**	-0.07*	-0.09**	0.00	-0.07*	-0.00	-0.06*	0.07*	1					
12	-0.01	-0.11***	-0.12***	-0.09**	-0.08**	0.05	0.05	0.04	-0.23***	-0.02	0.68***	1				
13	-0.08**	-0.05	-0.05	-0.05	-0.00	0.09**	0.32***	0.07*	-0.24***	-0.27***	0.20***	0.41**	1			
14	-0.03	0.01	0.01	0.02	0.00	0.05	-0.05	0.00	-0.00	-0.03	0.05	-0.00	-0.03	1		
15	0.06*	0.11***	0.15***	0.11***	0.04	-0.02	-0.06*	-0.05	0.06*	0.09**	-0.01	-0.08**	-0.08**	-0.00	1	
16	-0.08**	0.10**	0.08**	0.09**	-0.02	-0.02	0.00	-0.03	-0.00	0.04	-0.05	-0.06	0.01	0.06*	-0.11***	1

(1) Bidder CARs
(2) Board structure gap
(3) Board function gap
(4) Compensation policy gap
(5) shareholder rights gap
(6) Country governance gap
(7) Payment method dummy
(8) Cross-border dummy
(9) Same industry dummy
(10) Relative size
(11) Bidder leverage
(12) Bidder Tobin Q
(13) Bidder size
(14) Bidder run up
(15) GDP growth
(16) GDP per capita

Table 4: Bidder cumulative abnormal returns

The sample consists of 1026 completed international mergers and acquisitions listed in Securities Data Corporation (SDC) between 2003 and 2016. The ASSET4ESG database covers both the acquirer and target before an M&A deal. Our dependent variable is the bidder's 5-day cumulative abnormal returns around the announcement date. The main variable of interest ("Bidder-target governance gap") is the firm-level corporate governance difference between the bidder and the target governance indices: board structure index, board function index, compensation policy index, and shareholder rights index. These indices are based on 55 firm governance attributes from the ASSET4 ESG database having a percentage score from 0 (lowest) to 100 (highest). Other variables are defined in Appendix A and Appendix B. T-statistics are shown in parenthesis; Standard errors are corrected for heteroscedasticity (White, 1980). *, ** and *** show statistical significance level at 10%, 5% and 1% respectively. All regressions control for year, industry, and country fixed effects, whose coefficients are not shown for brevity.

Dependent variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Bidder CARs (-2, +2)	Board Structure	Board Function	Compensation Policy	Shareholder Rights	Board Structure	Board Function	Compensation Policy	Shareholder Rights
Bidder-target governance gap	0.0003*** (4.025)	0.0003*** (3.728)	0.0003*** (3.910)	0.0003*** (3.400)	0.0004*** (3.886)	0.0003*** (3.643)	0.0004*** (3.881)	0.0003*** (3.294)
Country governance gap					0.0000 (0.781)	0.0001 (0.873)	0.0001 (0.869)	0.0001 (0.836)
Payment method dummy					-0.0042 (-1.099)	-0.0040 (-1.062)	-0.0038 (-1.006)	-0.0037 (-0.977)
Cross-border dummy					-0.0116*** (-2.760)	-0.0116*** (-2.750)	-0.0117*** (-2.775)	-0.0113*** (-2.666)
Same industry dummy					-0.0052 (-1.275)	-0.0057 (-1.384)	-0.0058 (-1.416)	-0.0050 (-1.218)
Relative size					0.0076 (0.822)	0.0067 (0.725)	0.0070 (0.757)	0.0062 (0.674)
Bidder leverage					0.0014 (0.088)	0.0013 (0.084)	0.0013 (0.087)	0.0017 (0.112)
Bidder Tobin Q					0.0055 (0.433)	0.0055 (0.436)	0.0043 (0.342)	0.0056 (0.443)
Bidder size					-0.0023 (-1.572)	-0.0027* (-1.817)	-0.0025* (-1.698)	-0.0025* (-1.705)
Bidder run up					-0.0095 (-0.795)	-0.0098 (-0.816)	-0.0102 (-0.853)	-0.0096 (-0.803)
GDP growth					0.0023 (1.317)	0.0022 (1.258)	0.0023 (1.345)	0.0025 (1.449)
GDP per capita					-0.0316 (-1.646)	-0.0340* (-1.775)	-0.0353* (-1.843)	-0.0371* (-1.951)
Constant	0.0828*** (5.931)	0.0825*** (5.904)	0.0827*** (5.996)	0.0800*** (5.620)	0.4482** (2.227)	0.4775** (2.386)	0.4890** (2.445)	0.5050** (2.535)
Year, industry, and country dummies	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
<i>N</i>	1026	1026	1026	1026	1026	1026	1026	1026
<i>R</i> ²	0.1166	0.1133	0.1144	0.1107	0.1404	0.1376	0.1388	0.1340

* $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$

Table 5: Cross-border versus domestic deals

The sample consists of completed international mergers and acquisitions listed in Securities Data Corporation (SDC) between 2003 and 2016. The ASSET4ESG database covers both the acquirer and target before an M&A deal. Our dependent variable is the bidder's 5-day cumulative abnormal returns around the announcement date. The key independent variable ("Bidder-target governance gap") is the firm-level corporate governance difference between the bidder and the target governance indices: board structure index, board function index, compensation policy index, and shareholder rights index. These indices are based on 55 firm governance attributes from the ASSET4 ESG database having a percentage score from 0 (lowest) to 100 (highest). Other variables are defined in Appendix A and Appendix B. T-statistics are shown in parenthesis; Standard errors are corrected for heteroscedasticity (White, 1980). *, ** and *** show statistical significance level at 10%, 5% and 1% respectively.

Dependent variables	Cross-border deals				Domestic deals			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Bidder CARs (-2, +2)	Board Structure	Board Function	Compensation Policy	Shareholder Rights	Board Structure	Board Function	Compensation Policy	Shareholder Rights
Bidder-target governance gap	0.0004*** (2.941)	0.0004*** (2.665)	0.0004*** (2.919)	0.0004*** (2.873)	0.0003** (2.357)	0.0003** (2.445)	0.0003** (2.412)	0.0003** (1.988)
Country governance gap	0.0000 (0.543)	0.0000 (0.557)	0.0000 (0.566)	0.0000 (0.537)				
Bidder country governance					0.0019 (1.139)	0.0020 (1.242)	0.0019 (1.188)	0.0022 (1.311)
Payment method dummy	0.0014 (0.231)	0.0020 (0.321)	0.0020 (0.323)	0.0023 (0.380)	-0.0091* (-1.658)	-0.0095* (-1.736)	-0.0089 (-1.638)	-0.0089 (-1.633)
Same industry dummy	-0.0007 (-0.109)	-0.0009 (-0.139)	-0.0013 (-0.194)	-0.0002 (-0.036)	-0.0079 (-1.435)	-0.0082 (-1.494)	-0.0084 (-1.524)	-0.0078 (-1.419)
Relative size	0.0030 (0.211)	0.0007 (0.048)	0.0024 (0.172)	0.0009 (0.065)	0.0095 (0.813)	0.0101 (0.851)	0.0093 (0.794)	0.0087 (0.737)
Bidder leverage	0.0392 (1.421)	0.0404 (1.442)	0.0415 (1.496)	0.0405 (1.464)	-0.0152 (-0.804)	-0.0161 (-0.856)	-0.0162 (-0.860)	-0.0153 (-0.818)
Bidder Tobin Q	-0.0195 (-0.824)	-0.0208 (-0.872)	-0.0227 (-0.953)	-0.0183 (-0.780)	0.0130 (0.841)	0.0136 (0.883)	0.0127 (0.826)	0.0131 (0.849)
Bidder size	0.0012 (0.461)	0.0007 (0.276)	0.0010 (0.364)	0.0007 (0.260)	-0.0030* (-1.659)	-0.0031* (-1.746)	-0.0031* (-1.721)	-0.0030* (-1.656)
Bidder run up	-0.0223 (-0.977)	-0.0201 (-0.867)	-0.0215 (-0.934)	-0.0212 (-0.910)	-0.0058 (-0.410)	-0.0062 (-0.435)	-0.0067 (-0.468)	-0.0060 (-0.424)
GDP growth	0.0005 (0.184)	0.0003 (0.117)	0.0003 (0.133)	0.0008 (0.308)	0.0040* (1.764)	0.0039* (1.730)	0.0041* (1.815)	0.0042* (1.854)
GDP per capita	-0.0484 (-1.502)	-0.0540 (-1.649)	-0.0554* (-1.686)	-0.0540 (-1.649)	-0.0346 (-1.351)	-0.0329 (-1.281)	-0.0358 (-1.396)	-0.0391 (-1.537)
Constant	0.5465 (1.643)	0.6167* (1.828)	0.6256* (1.852)	0.6061* (1.799)	0.2787 (0.850)	0.2433 (0.734)	0.2820 (0.857)	0.2936 (0.885)
Year, industry, and country dummies	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	377	377	377	377	649	649	649	649
R ²	0.2623	0.2554	0.2609	0.2561	0.1840	0.1859	0.1840	0.1808

Table 6: Robustness tests

The sample consists of 1026 completed international mergers and acquisitions listed in Securities Data Corporation (SDC) between 2003 and 2016. The ASSET4ESG database covers both the acquirer and target before an M&A deal. The key independent variable (“Bidder-target governance gap”) is the firm-level corporate governance difference between the bidder and the target governance indices: board structure index, board function index, compensation policy index, and shareholder rights index. These indices are based on 55 firm governance attributes from the ASSET4 ESG database having a percentage score from 0 (lowest) to 100 (highest). The results for 11-day CARs are presented in Panel A. Panel B shows results for different firm corporate governance measurements. In Panel C, we show results for two different periods of the sample. Other variables are defined in Appendix A and Appendix B. T-statistics are shown in parenthesis; Standard errors are corrected for heteroscedasticity (White, 1980). *, ** and *** show statistical significance level at 10%, 5% and 1% respectively. All regressions control for year, industry, and country fixed effects, whose coefficients are not shown for brevity.

Panel A: 11-day Bidder cumulative abnormal returns								
Dependent variables	(1)	(2)	(3)	(4)				
Bidder CARs (-5, +5)	Board Structure	Board Function	Compensation Policy	Shareholder Rights				
Bidder-target governance gap	0.0005 ^{***} (4.267)	0.0004 ^{***} (4.191)	0.0004 ^{***} (4.256)	0.0004 ^{***} (3.945)				
Control variables and constant	Yes	Yes	Yes	Yes				
Year, industry, and country dummies	Yes	Yes	Yes	Yes				
<i>N</i>	1026	1026	1026	1026				
<i>R</i> ²	0.1518	0.1508	0.1510	0.1487				
Panel B: Alternative measures of firm governance								
Dependent variables	(1)	(2)	(3)	(4)	(5)	(6)		
Bidder CARs (-2, +2)	Average index	PCA index	Board Structure	Board function	Compensation Policy	Shareholder Rights		
Bidder-target governance gap	0.0004 ^{***} (3.752)	0.0068 ^{***} (3.857)	0.0003 ^{***} (3.620)	0.0003 ^{***} (3.557)	0.0003 ^{***} (3.937)	0.0003 ^{***} (3.211)		
Control variables and constant	Yes	Yes	Yes	Yes	Yes	Yes		
Year, industry, and country dummies	Yes	Yes	Yes	Yes	Yes	Yes		
<i>N</i>	1026	1026	1026	1026	1026	1026		
<i>R</i> ²	0.1391	0.1385	0.1365	0.1353	0.1389	0.1316		
Panel C: Sub-periods of sample								
	2003-2009				2010-2016			
Dependent variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Bidder CARs (-2, +2)	Board Structure	Board Function	Comp. Policy	Share. Rights	Board Structure	Board Function	Comp. Policy	Share. Rights
Bidder-target gov. gap	0.0004 ^{***} (2.695)	0.0003 ^{**} (2.278)	0.0004 ^{**} (2.490)	0.0004 ^{**} (2.579)	0.0004 ^{***} (2.909)	0.0004 ^{***} (3.078)	0.0003 ^{***} (3.107)	0.0003 ^{***} (2.630)
Control variables and constant	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year, industry, and country dummies	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
<i>N</i>	494	494	494	494	532	532	532	532
<i>R</i> ²	0.2106	0.2041	0.2063	0.2047	0.1901	0.1926	0.1902	0.1870

* $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$

Table 7: Portability and bidder's country governance

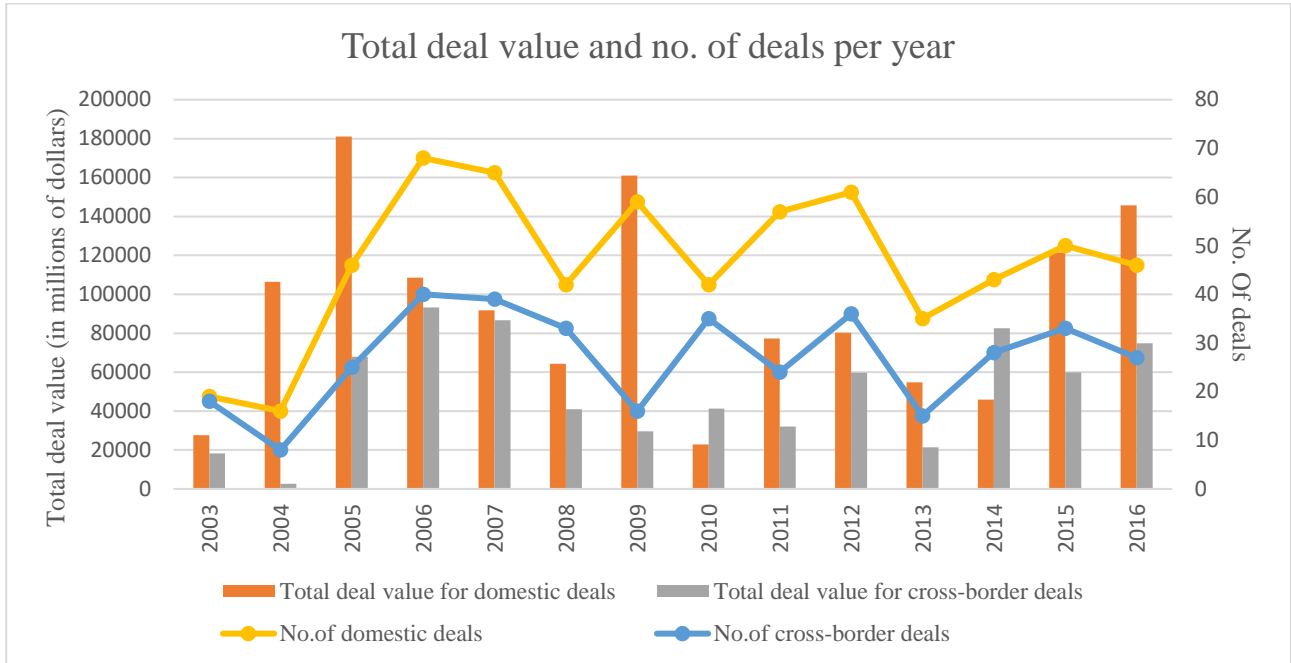
The sample consists of 1026 completed international mergers and acquisitions listed in Securities Data Corporation (SDC) between 2003 and 2016. The ASSET4ESG database covers both the acquirer and target before an M&A deal. Our dependent variable is the bidder's 5-day cumulative abnormal returns around the announcement date. The variable of interest is the interaction between the better-governed country (measured with WGI and ASDI) and the bidder-target governance gap (B-T gap). We create a dummy variable that equals one if the country governance is above the world median (High WGI/High ASDI) and zero otherwise. The B-T gap is the firm-level corporate governance difference between the bidder and the target governance indices: board structure index, board function index, compensation policy index, and shareholder rights index. These indices are based on 55 firm governance attributes from the ASSET4 ESG database having a percentage score from 0 (lowest) to 100 (highest). Other variables are defined in Appendix A and Appendix B. T-statistics are shown in parenthesis; Standard errors are corrected for heteroscedasticity (White, 1980). *, ** and *** show statistical significance level at 10%, 5% and 1% respectively. All regressions control for year, industry, and country fixed effects, whose coefficients are not shown for brevity.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Dependent variables	Board	Board	Compensation	Shareholder	Board	Board	Compensation	Shareholder
Bidder CARs (-2, +2)	Structure	Function	Policy	Rights	Structure	Function	Policy	Rights
B-T gap	-0.0002 (-0.507)	-0.0002 (-0.651)	-0.0002 (-0.649)	-0.0004 (-0.958)	0.0001 (0.635)	0.0001 (0.413)	0.0001 (0.409)	0.0000 (0.280)
Higher Bidder WGI	-0.0335 (-1.342)	-0.0343 (-1.295)	-0.0419 (-1.579)	-0.0433 (-1.494)				
Higher Bidder WGI x B-T gap	0.0006* (1.701)	0.0006* (1.717)	0.0006* (1.876)	0.0007* (1.840)				
High ASDI					-0.0415*** (-2.811)	-0.0439*** (-2.986)	-0.0457*** (-3.067)	-0.0434*** (-3.015)
High ASDI x B-T gap					0.0004** (2.374)	0.0004** (2.385)	0.0004** (2.516)	0.0004** (2.496)
Control variables and constant	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year, industry, and country dummies	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
<i>N</i>	1026	1026	1026	1026	1026	1026	1026	1026
<i>R</i> ²	0.1432	0.1405	0.1422	0.1392	0.1032	0.0998	0.1023	0.0965

p*<0.1; *p*<0.05; ****p*<0.01

Figure 1.

This figure reveals the total deal value (in millions of dollars) and the number of deals of all acquisitions led by bidders over 2003 to 2016. The data are obtained from the Securities data corporation (SDC).



Appendix A: Variable definitions

Variable	Definition
Panel A: Cumulative Abnormal Returns	
Bidder CARs	5-day bidder cumulative abnormal returns around the announcement date. The CARs are calculated using the market model for the period (-255, -25). Source: DataStream.
Panel B: Firm-level governance indices	
Board Structure index	Taken from ASSET4ESG, based on lagged average of 16 variables (definitions in appendix B).
Board function index	Taken from ASSET4ESG, based on lagged average of 15 variables (definitions in appendix B).
Compensation policy index	Taken from ASSET4ESG, based on lagged average of 13 variables (definitions in appendix B).
Shareholder rights index	Taken from ASSET4ESG, based on lagged average of 11 variables (definitions in appendix B).
Panel C: Bidder's country characteristics	
WGI index	It is the average index based on six country governance dimensions proposed by Kaufmann, Kraay, and Mastruzzi (2009). These dimensions include control of corruption, political stability, govt. Effectiveness, the rule of law, voice and accountability, and regulatory quality. Source: World Governance Indicators.
GDP growth	Annual growth in real GDP. Source: World Development Indicators.
Log GDP per capita	Log of real GDP (current US dollars)/average population. Source: World Development Indicators.
Panel D: deal characteristics	
Payment method	Dummy variable: 1 for the purely cash-financed deal, 0 otherwise. Source: Securities Data Corporation.
Cross border deal	Dummy variable: 1 if cross border deal, 0 otherwise. Source: Securities Data Corporation.
Same industry deal	Dummy variable: 1 for same industry deal, 0 otherwise. Source: Securities Data Corporation.
Relative size	Deal value/Bidder market value of equity. Sources: Securities Data Corporation and World Scope.
Panel E: Bidder characteristics	
Bidder run-up	The sum of abnormal returns using the market model for a window of 90 days up to 20 days before deal announcement. Source: DataStream.
Leverage	Long-term debt/total assets. Source: WorldScope.
Tobin's Q	$(\text{assets} - \text{book value of equity} + \text{market value of equity}) / \text{assets}$. Source: WorldScope.
Size	Natural logarithm of book value of assets. Source: WorldScope.

Appendix B: Definitions of the firm-level governance variables from the ASSET4ESG

A. Board Structure index

- | | |
|---|--|
| (1) Background and skills | “Does the company describe the professional experience or skills of every board member? OR Does the company provide information about the age of individual board members?”. |
| (2) Board Diversity | “Percentage of female on the board.” |
| (3) Board Member Affiliations | “Average number of other corporate affiliations for the board member.” |
| (4) CEO-Chairman Separation | “Does the CEO simultaneously chair the board? AND has the chairman of the board been the CEO of the company?”. |
| (5) Experienced Board | “Average number of years each board member has been on the board.” |
| (6) Implementation | “Does the company describe the implementation of its balanced board structure policy?”. |
| (7) Improvements | “Does the company have the necessary internal improvement and information tools to develop balanced board structure?”. |
| (8) independent board members | “Percentage of independent board members as reported by the company.” |
| (9) Individual Reelection | “Are all board members individually subject to re-election (no classified or staggered board structure)?”. |
| (10) Mandates Limitation | “Does the company provide information about the other mandates of individual board members? AND Does the company stipulate a limit of the number of years of board membership?”. |
| (11) Monitoring | “Does the company monitor the board functions through the establishment of a nomination committee?”. |
| (12) non-executive board members | “Percentage of non-executive board members.” |
| (13) Policy | “Does the company have a policy for maintaining a well-balanced membership of the board?”. |
| (14) Size of Board | “Total number of board members which are in excess of ten or below eight.” |
| (15) Specific Skills | “Percentage of board members who have either an industry specific background or a strong financial background.” |
| (16) Strictly Independent Board Members | “Percentage of strictly independent board members (not employed by the company; not representing or employed by a majority).” |

B. Board Function index

- | | |
|--|---|
| (1) Audit Committee Expertise | “Does the company have an audit committee with at least three members and at least one "financial expert" within the meaning of Sarbanes-Oxley?”. |
| (2) Audit Committee Independence | “Percentage of independent board members on the audit committee as stipulated by the company.” |
| (3) Audit Committee Management Independence | “Does the company report that all audit committee members are non-executives?”. |
| (4) Board Attendance | “Does the company publish information about the attendance of the individual board members at board meetings?”. |
| (5) Board Meetings | “Number of board meetings per year.” |
| (6) Compensation Committee Independence | “Percentage of independent board members on the compensation committee as stipulated by the company.” |
| (7) Compensation Committee Management Independence | “Does the company report that all compensation committee members are non-executives?”. |
| (8) Implementation | “Does the company describe the implementation of its board functions policy?”. |
| (9) improvements | “Does the company have the necessary internal improvement and information tools to develop appropriate and effective board functions?”. |
| (10) Monitoring | “Does the company monitor the board functions through the establishment of a corporate governance committee?”. |

- | | |
|---|--|
| (11) Nomination committee independence | “Percentage of non-executive board members on the nomination committee.” |
| (12) Nomination committee involvement | “Percentage of nomination committee members who are significant shareholders (more than 5%).” |
| (13) Nomination Committee Management Independence | “Are the majority of the nomination committee members non-executives?”. |
| (14) Nomination Committee Processes | “Does the nomination committee have the responsibility for the selection, appointment and succession procedures for board members or executives?” OR Does the company report or show to constantly supervise the performance of board members or executives?”. |
| (15) Policy | “Does the company have a policy for maintaining effective board functions?”. |

C. Compensation Policy index

- | | |
|---|---|
| (1) Board Member Compensation | “Total compensation of the non-executive board members in US dollars.” |
| (2) Compensation Controversies | “Is the company under the spotlight of the media because of a controversy linked to high executive or board compensation?”. |
| (3) Highest remuneration package | “Highest remuneration package within the company in US dollars.” |
| (4) Implementation | “Does the company describe the implementation of its compensation policy?”. |
| (5) Improvements | “Does the company have the necessary internal improvement and information tools to develop attractive and performance-oriented compensation policy?”. |
| (6) Individual compensation | “Does the company provide information about the total individual compensation of all executives and board members?”. |
| (7) Long Term Objectives | “Is the management and board members remuneration partly linked to objectives or targets which are more than two years forward looking?”. |
| (8) Monitoring | “Does the company monitor the senior executives and board compensation through the establishment of a compensation committee?”. |
| (9) Policy | “Does the company have a policy for performance-oriented compensation that attracts and retain the senior executives and board members?”. |
| (10) Remuneration structure | “Does the company subdivide the remuneration of executives according to fixed salaries, bonuses and stock option plans (or restricted stocks)?”. |
| (11) Stock compensation | “Do the companies most recently granted stocks or stock options vest in a three-year period at a minimum?”. |
| (12) Stock option program | “Does the company’s a statute or by-laws require that stock-options are only granted with a vote at a shareholder meeting?”. |
| (13) Sustainability Compensation Incentives | “Is the senior executive's compensation linked to CSR/H&S/Sustainability targets?”. |

D. Shareholder Rights index

- | | |
|---------------------------------------|--|
| (1) Anti-takeover devices | “The number of anti-takeover devices in place in excess of two.” |
| (2) Available articles of association | “Are the company’s articles of association, statutes or bylaws publicly available or on request?”. |
| (3) Implementation | “Does the company describe the implementation of its shareholder rights policy?”. |
| (4) Improvements | “Does the company have the necessary internal improvement and information tools to develop appropriate shareholder rights principles?” |
| (5) Majority shareholders | “Percentage of shares held by all insiders and 5% owners.” |
| (6) Monitoring | “Does the company monitor the shareholder rights through the establishment of a corporate governance committee?”. |
| (7) Ownership | “Is the company owned by a reference shareholder who has the majority of the voting rights, veto power or golden share?”. |

- (8) Policy “Does the company have a policy for ensuring equal treatment of minority shareholders, facilitating shareholder engagement or limiting the use of anti-takeover devices?”.
- (9) Share structure “Is the company's outstanding equity constituted of 100% common stocks?”.
- (10) Shareholder controversies “Is the company under the spotlight of the media because of a controversy linked to shareholders rights?”.
- (11) Voting rights “Are all shares of company providing equal rights?”.

Internet Appendix: Updated data by ASSET4 ESG

The sample consists of completed international mergers and acquisitions listed in Securities Data Corporation (SDC) between 2003 and 2016. The ASSET4ESG database covers both the acquirer and target before an M&A deal. The key independent variable (“Bidder-target governance gap”) is the firm-level corporate governance difference between the bidder and the target governance scores of the updated categories of governance, management, and shareholder rights. The management and shareholder rights scores are weighted averages of individual governance attributes (67 in the management category and 50 in shareholders) under each category, and governance score is the weighted average based on management, shareholder, and CSR categories. These categories have a percentage score from 0 (lowest) to 100 (highest). The results for 5-day CARs are presented in the table. Other variables are defined in Appendix A and Appendix B. T-statistics are shown in parenthesis; Standard errors are corrected for heteroscedasticity (White,1980). *, ** and *** show statistical significance level at 10%, 5% and 1% respectively. All regressions control for year, industry, and country fixed effects, whose coefficients are not shown for brevity.

Dependent variables: Bidder CARs (-2, +2)	(1) Governance	(2) Management	(3) Shareholder Rights
Bidder-target governance gap	0.0002** (2.283)	0.0002** (2.525)	0.0001 (1.414)
Country governance gap	0.0000 (0.701)	0.0000 (0.698)	0.0000 (0.765)
Payment method dummy	-0.0031 (-0.787)	-0.0030 (-0.783)	-0.0026 (-0.670)
Cross-border dummy	-0.0118*** (-2.691)	-0.0117*** (-2.681)	-0.0114** (-2.580)
Same industry dummy	-0.0049 (-1.171)	-0.0048 (-1.159)	-0.0050 (-1.186)
Relative size	0.0022 (0.247)	0.0016 (0.183)	0.0006 (0.072)
Bidder leverage	0.0012 (0.074)	0.0029 (0.178)	0.0001 (0.005)
Bidder Tobin Q	0.0108 (0.818)	0.0098 (0.744)	0.0117 (0.885)
Bidder size	-0.0039** (-2.523)	-0.0037** (-2.408)	-0.0034** (-2.198)
Bidder run up	-0.0112 (-0.873)	-0.0116 (-0.906)	-0.0111 (-0.860)
GDP growth	0.0026 (1.496)	0.0025 (1.456)	0.0029* (1.657)
GDP per capita	-0.0371* (-1.914)	-0.0372* (-1.928)	-0.0393** (-2.013)
Constant	0.5373*** (2.665)	0.5377*** (2.677)	0.5513*** (2.718)
Year, industry, and country dummies	Yes	Yes	Yes
<i>N</i>	998	1000	1000
<i>R</i> ²	0.1268	0.1278	0.1215

* $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$