



Application of Mediating Effect Test in Social Science Research: an Empirical Analysis of Geographic and Institutional Factors

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ABSTRACT

Test for mediating effect is an important method in social science research. In this paper, we applied mediating effect test in corporate acquisition research. Acquisition is one of the most important ways to expand a company, especially in emerging markets. From the perspective of institutional view, we made an empirical research on the relationship between geographic and institutional factors and the acquisition performance based on a sample of acquisitions in China. We found that acquisition legitimacy based on different region, including external and internal legitimacy, has positive effect on acquisition performance. We conclude that cross-region acquisition has negative influence on external legitimacy of acquisition, while having no significant influence on internal legitimacy of acquisition.

Keywords: corporate acquisition (CA), acquisition performance (AP), acquisition legitimacy (AL), institutional view (IV), geographic factor (GF)

INTRODUCTION

Mediating effect is a common way of interaction among variables in social science research. Therefore, effective testing of mediating effects is crucial for revealing relationships among variables. In this paper, we focus on the mediating effect of geographical and institutional factors in acquisitions and make an empirical analysis based on Chinese acquisitions. With reform and opening-up, and the development of the market economy, Chinese local enterprises have achieved rapid growth, and the market scale has achieved rapid expansion (Cui & Jiang, 2012). Many small companies became no longer satisfied with the local market within its own region, and began to operate in other cities or provinces (Yue, 2017). Cross-region acquisition has become one of the most important ways to make cross-region development. Cross-region acquisition can bring economy of scale and economy of scope for the enterprises, because enterprises can make full use of the resources of different regions to achieve synergies and get new internal advantage (Chakrabarti & Mitchell, 2016). At the same time it can be provide new markets and growth opportunities for the enterprise. The business unit in different areas can share the company's core competence in cross-region business. Cross-region acquisition can also provide more opportunities for learning (Trichterborn et al., 2016). However, the fragmentation of power in different areas in China may bring cross-region acquisitions difficulties. For example, when Baogang Group wanted to acquire the Jilin Steel Company, it was resisted by the

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State of the literature

- Mediating effect is a common way of interaction among variables in social science research. Therefore, effective testing of mediating effects is crucial for revealing relationships among variables.
- Cross-region acquisition can bring economy of scale and economy of scope for the enterprises, because enterprises can make full use of the resources of different regions to achieve synergies and get new internal advantage.
- Due to the dispersion and complexity of Chinese markets, the Chinese enterprises will encounter great difficulties and obstacles in coordinating different regions and finally obtaining combined benefits.

Contribution of this paper to the literature

- External legitimacy plays a significant mediating role between regional variables and performance variables. Low external legitimacy of cross-regional acquisitions is an important reason why cross-regional acquisitions have negative impacts on acquisition performance when compared to acquisitions in the same region.
- The regional factors of the acquiring and acquired firms significantly affect the acquisition performance of the acquiring firm.
- Cross-region acquisitions will be subject to multiple institutional pressures from local stakeholder groups, thus resulting in external legitimacy problems.

local government in Shandong, and the acquisition finally failed. Even if cross-region acquisitions can occur smoothly, due to the dispersion and complexity of Chinese markets, the Chinese enterprises will encounter great difficulties and obstacles in coordinating different regions and finally obtaining combined benefits. In reality, we can see a lot of failures in cross-regional acquisitions. For example, the Tonggang incident in 2009 was due to the boycott of the employees and the acquisition finally failed.

Can cross-region acquisitions bring better performance compared to the same-region acquisitions? And what difficulties will these enterprises encounter in the process of cross-regional acquisitions? This is a worthy subject. Unfortunately, from the existing literature, we can find little research on the impacts of regional factors on acquisition performance, especially lacking empirical analysis. Considering the institutional factors, this paper introduces the concept of legitimacy to explore the relationship between regional factors, legitimacy and acquisition performance in China from the perspective of institutional-based view, so to provide a theoretical reference for enterprises' decision making in acquisitions.

LITERATURES REVIEWING

As the largest emerging market country in the world, China is still in the period of economic transition with various imperfect institutions, and the impact of institutional factors will be greater (Hoskisson et al., 2000). Acquisitions will affect the internal and external stakeholder, and the attitude of stakeholders reflects the level of legitimacy of acquisitions (Chan & Makino, 2007). The strategic behavior of an enterprise will affect its level of legitimacy, and different levels of legitimacy will influence the enterprise' performance. According to the theory of institutional-based theory, the legitimacy of enterprise behaviors can be divided into external legitimacy and internal legitimacy (Dacin, Oliver & Roy, 2007). The external legitimacy of acquisitions refers to the degree of recognition and support from the government, the upstream and downstream enterprises, the public, etc., in the regions where the acquiring and acquired enterprises are located especially where the acquired enterprises are located. The internal legitimacy of acquisitions emphasizes the recognition and support received by the shareholders, management and general employees of the acquired enterprises.

Region, External Legitimacy and Acquisitions Performance

The level of external legitimacy obtained from acquisitions has an important impact on enterprises. Firstly, in China, government authority is of great significance for enterprises to conduct their business and maintain their market positions (He & Li, 2000). So in many cases, the support from the government plays a decisive role in the

success of acquisitions and post-acquisition performance. Besides, the local protectionism in each administrative area is serious, and the government officials at various levels will make a lot of demands and restrictions on enterprises, especially foreign enterprises for consideration of their achievements. For firms who want to enter into a new area or market but do not have sufficient external legitimacy, the institutional environment seems expensive and difficult to manage, and it will cost a lot (Bertrand, Betschinger & Settles, 2016). As for enterprises that can meet the expectations of the government, they will acquire policy and resource support. In addition, the relationship between enterprises and their upstream and downstream manufacturers is in a critical position in the enterprise value chain, which is of strategic significance for the development of enterprises (Kim & Finkelstein, 2009). Obtaining more recognition and support from upstream and downstream enterprises is helpful to reduce the relationship costs and search costs after acquisitions, and also conducive to learning among partners. In addition, research shows that the corporate social responsibility and response of the public are closely related to the enterprises' strategy, good social responsibility image is essential to business development (Suchman, 1995). Authoritative social public organizations, such as public interest groups, local associations, professional or expert associations, can closely monitor whether companies comply with social norms and social expectations (DiMaggio & Powell, 1983). To some extent, these social organizations have the power to make rules, standards and principles, whether they can acquire the support from these public organizations will have a significant impact on the success and performance of acquisition. That is to say, the external legitimacy is theoretically helpful to achieve the expected goal of acquisition.

However, compared with same-regional acquisitions, cross-regional acquisitions will bring a negative impact on the external legitimacy of enterprises (Shimizu et al., 2004). From the perspective of local government departments, local taxes may be affected by local enterprises acquired by foreign companies, especially when the acquirers cancel the independent legal personalities of the acquired enterprises. From the perspective of personal interests of relevant officials, senior officials who are familiar with situations may leave because of acquisitions, which will lead to a certain degree of inconvenience after acquisitions and may also affect the potential interest channels. Similarly, for the local upstream and downstream enterprises, cross-regional acquisitions may lead to changes in executives of former firms so as to bring problems in the cooperation. At the same time, cultural differences between foreign and local enterprises may also lead to communication problems and weakening of learning effects. And from the local social institutions and the public, they may worry that outsiders lack local affection. This will lead to absence of social responsibility, therefore they may have certain conflict with outsiders or give more responsibilities and expectations to outsiders. So, compared to the same-region acquisitions, cross-regional acquisitions may be resisted by various external stakeholders. Overall, cross-regional acquisitions will lead to the challenges of acquirers' external legitimacy, which will directly affect the acquisition performance. Therefore, this paper proposes the following hypothesis:

- H1:** The external legitimacy of acquisition plays a mediating role between regional factors and acquisition performance.

Region, Internal Legitimacy and Acquisition Performance

Enterprises need to obtain legitimacy not only from the external institutional environment but also internally (Yue, Li & Jiang, 2016). Internal legitimacy is especially important for acquirers, because getting enough identification and support from the acquiring enterprises will directly affect the operation of the acquirers in post-acquisition (Cording, Christmann & King, 2008). If it is not a whole acquisition, obtaining more recognition from the original shareholders and board members of the acquiring enterprise will make decision-making more unified and efficient after the acquisition, and make the subsequent resource support more likely. Long-term and stable resource support can benefit the market expansion after acquisition and provide more powerful guarantee for the acquisition performance (Li & Zhou, 2007). From the perspective of the management, lower internal legitimacy means that the support from the management of the acquiring enterprises is not high, which will lead to conflicts and operational inefficiencies in internal decision-making after acquisitions. Whether the purpose of acquisitions is to enter a new market or develop new business or expand existing business and market status, the recognition and support of the original manager from the acquired enterprises directly affects the progress of the acquisitions

or the operation after acquisitions (Inkpen, Sundaram & Rockwood, 2000). If the managers from the acquired enterprises have a high degree of acceptance for the acquisition, they will use their experience and social relations to maintain and develop business after the acquisition, which will help reduce the coordination costs and promote information exchange between the acquiring and acquired sides. The smooth information transfer mechanism will make the acquirers' strategic intention transfer more efficient, the managers from the acquired enterprises can more easily understand the main purpose and strategy of the acquirers so to form more consistent strategic interests, and also reduce the agency costs and opportunism risks after the acquisition to a certain extent, which is beneficial to the acquirers to achieve their acquisition goals. From the perspective of the staff, if the employee of the acquired firm supports the acquisition, this will affect the reorganization and integration of the acquirers, and even directly affect the success of the acquisitions. The higher acceptance and recognition of the former employees of the acquired enterprise has, the better coordination and cooperation between the two sides of the acquisition will be, and employees from the acquired enterprise will be willing to make efforts to continue learning and communication, and can thus achieve consensus on corporate culture and values more easily and quickly so that the acquired side has an easier understanding of the enterprise's overall strategic targets. Employees from both sides will also face the challenges from the external environment of enterprises on the basis of consensus. Moreover, in the long run, the unified organizational culture formed on the basis of the high degree of consensus after acquisition will remain steady for a longer period of time, which will play a key role in the future development of the acquiring enterprise. Additionally, according to the view of organizational behavior, the higher recognition of corporate behaviors the employees have, the stronger informal communication and knowledge sharing among employees will be. These can promote the effects of organizational learning, therefore help achieve a whole strategic interest for the acquirers.

However, compared to same-regional acquisitions, cross-regional acquisitions will have some challenges for the internal legitimacy of acquirers. First of all, cross-regional acquisitions are more likely to cause job changes and interest loss, because the acquirers may replace some of the original executives since they would want to implement a stronger control to achieve better integration and operation, or they worry that original managers may produce conflicts or potential opportunistic behaviors. Secondly, from the perspective of the acquired enterprise's employees, there will be a conflict between different cultures. Besides, the degree of personnel changes may be higher and cause greater impact (Bruton, Oviatt & White, 1994). To sum up, the internal legitimacy of acquisitions has an impact on the acquisition performance, and cross-regional acquisitions will bring challenges to internal legitimacy of the acquirers. Thus, this paper proposes the following hypothesis:

H2: The internal legitimacy of acquisition plays a mediating role between regional factors and acquisition performance.

RESEARCH DESIGN

Sample

This study uses questionnaire survey to obtain first-hand data for empirical analysis. The samples of the survey are enterprises that have carried out acquisitions, and an acquisition forms a sample. Based on the design of this study, acquisitions refer to the acquisition of assets or equity by the acquiring enterprise, thus becoming the largest shareholder of the acquired company. The respondents are executives or persons directly responsible for acquisitions. A total of 282 questionnaires were issued and 133 were recovered, of which 123 were valid, and the effective rate was 43.62%. Nearly 80% of the 123 respondents are senior and middle managers (mainly including the chairman, general manager or deputy general manager and department head), so the quality of the questionnaire was well guaranteed. The proportion of acquisitions in the sample occurring within the last five years is close to 80%, which can be regarded as a good memory for acquisitions and further enhance the reliability of the questionnaire.

Variables

- (a) Region. The regional factor (REG) was a 0-1 dummy variable in the study. As China's most basic administrative unit is province, this study defines cross-region as cross-province. If the acquiring and acquired sides are located in different provinces, the value is 1, otherwise the value is 0.
- (b) Acquisition legitimacy. This study refers to Chan and Makino (2007) and Dacin et al. (2007) to design the measurement of acquisition legitimacy. External validity (EX_LEG) consists of five items, respectively measuring the extent to which the government, suppliers, customers, important social organizations and the public of the acquired enterprise are in support of the acquisition. Internal legitimacy (IN_LEG) consists of three items, respectively measuring the extent to which the original management, general staff, and shareholders of the acquired enterprise are in support of the acquisition. Both external and internal legitimacy are measured using Likert five points method, with the highest support value of 5 and the minimum value of 1. As there is no empirical research on the measurement of legitimacy in China at present, we tested the reliability and validity of the variable measurement after the questionnaires were collected. The results showed that both the external and internal legitimacy of the Cronbach's Alpha values were greater than 0.9, and the coefficients of internal consistency of each project were greater than 0.8, the values of Cronbach's Alpha if Item Deleted were less than the values of Cronbach's Alpha, so the variables were proved to be of good reliability. The factor analysis showed that the factor loadings of each item were greater than 0.7, and the cumulative variation explained more than 70%, indicating that the variables have good validity.
- (c) Acquisition performance. This study refers to Hunt (1990), Datta (1995), and Capron and Hulland (2009) to measure the acquisition performance (PERF) of the acquirers from the market share, sales revenue, profits, profitability, and cash flow. By setting up related questions in the questionnaire, the respondents determine the extent to which the acquirers achieve their desired goals in all respects compared to the expected target, Likert five points method is used to measure the performance of acquisition.
- (d) Control variables. Combined with previous research on factors affecting acquisitions, this study sets up controlling variables such as shareholding ratio of state-owned shares of the acquirer, acquisition experience, acquisition performance of the acquired enterprise, relative scale in the regression model. Specific measures are as follows: 1) State-owned shares of the acquirers (STAT): proportion of state-owned shares of acquirers. 2) Acquisition experience (EXP): the richness of acquisition experience with acquirers before this acquisition, measured by Likert five points. 3) Shareholding ratio (SHARE): the equity ratio of the acquired enterprise that the acquirers obtain through this acquisition. 4) Performance of the target relative to the industry average (POT): the performance of the acquired firms, measured by Likert five points. 5) Relative size (SIZE): relative to the acquiring enterprise, the size of the acquired enterprise. The relation model of the variables is shown in [Figure 1](#).

ANALYSIS OF THE RESULTS

[Table 1](#) shows the mean, standard deviation and Pearson-correlation coefficient matrix of each variable. It is worth to point out that the average value of regional factors was 0.34, which means that 34% of the samples are cross-regional acquisitions, that is, 42 of the 123 acquisition samples are cross-province. From the correlation coefficient of variables, we can see that the acquisition performance has positive correlation with external legitimacy and internal legitimacy, but has no significant correlation with regional factors. And regional factor has a significant positive correlation with external legitimacy, but has no significant correlation with internal legitimacy. The results of the correlation analysis are a preliminary description of the relationship between variables, and further regression analysis is necessary to more precisely examine the relationships between variables in the hypothesis. This study sets the following models to examine the mediating effect of legitimacy on the structure and acquisition performance, and the regression results of this model are shown in [Table 2](#).

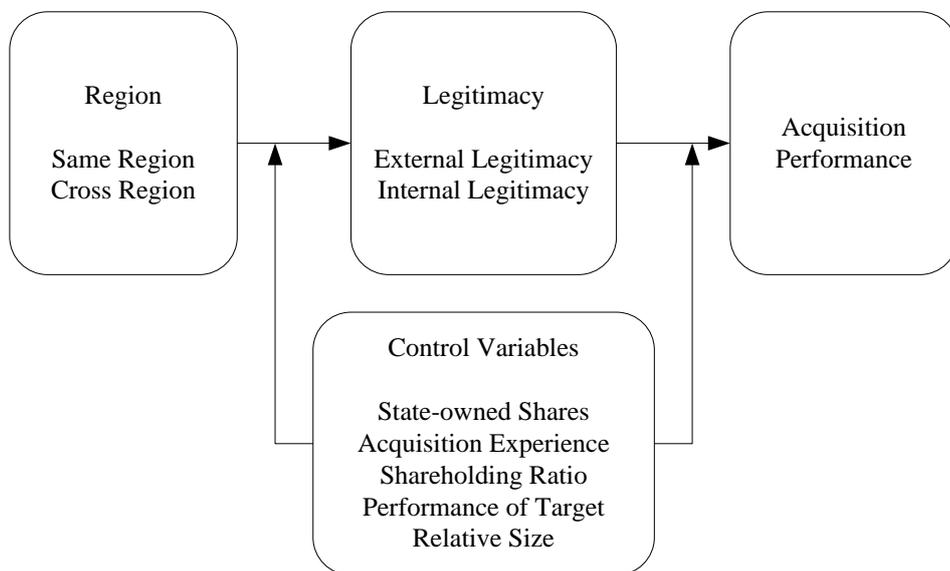


Figure 1. The relation model of the variables

Table 1. The correlation coefficient matrix of all variables in the study

Variable	Mean	St.D.	PERF	EX_LEG	IN_LEG	REG	SHARE	NAT	EXP	POT
PERF	3.78	0.96								
EX_LEG	3.89	0.89	0.24**							
IN_LEG	4.17	0.65	0.42***	0.668***						
REG	0.34	0.48	0.01	-0.243**	-0.01					
SHARE	0.63	0.34	-0.28**	0.05	-0.18**	0.13				
NAT	0.58	0.46	0.04	0.295**	0.19*	-0.52***	-0.26**			
EXP	2.89	1.14	0.54***	0.26**	0.29**	0.25**	-0.23*	0.02		
POT	2.93	1.37	0.51***	0.11	0.33***	0.31***	-0.17*	0.07	0.39***	
SIZE	2.31	1.2	-0.12	0.04	0.11	0.19*	-0.16*	-0.31***	0.01	0.14

*p<0.1, **p<0.01, ***p<0.001

Table 2. The regression results of the models in the study

Variable	Model 1		Model 2		Model 3		Model 4		Model 5	
	PERF	PERF	EX_LEG	EX_LEG	PERF	PERF	IN_LEG	IN_LEG	PERF	PERF
	Coefficient	t-value								
REG	-0.66***	-3.93	-0.54**	-2.75	-0.58**	-3.36	-0.08	-0.54	-0.63***	-3.93
EX_LEG					0.16*	1.97				
IN_LEG									0.34**	3.47
STATE	-0.61***	-3.55	0.51*	2.56	-0.69***	-3.95	0.24	1.56	-0.70***	-4.17
EXP	0.34***	5.63	0.28***	3.98	0.30***	4.67	0.11*	2.04	0.30***	5.15
SHARE	-0.50*	-2.5	0.74**	3.19	-0.61**	-2.99	-0.04	-0.21	-0.49*	-2.55
POT	0.34***	6.49	0.04	0.68	0.33***	6.43	0.12*	2.47	0.30***	5.85
SIZE	-0.20**	-3.54	0.15*	2.34	-0.22***	-3.92	0.07	1.42	-0.22***	-4.13
Adj_R ²	0.5		0.23		0.52		0.14		0.55	
F-value	21.74***		7.09***		19.66***		4.40***		22.12***	

*p<0.1, **p<0.01, ***p<0.001

As seen from **Table 2**, in model 1, the regression coefficient of regional factors was -0.66 ($p < 0.001$), which shows that regional factors can significantly explain variation in the acquisition performance, and the coefficient is negative indicating that cross-regional acquisitions will have a negative impact on acquisition performance. Model 2 and model 3 play a mediating role in testing external legitimacy, model 4 and model 5 play a mediating role in testing internal legitimacy. The results of model 2 show regression coefficient of regional factors and external legitimacy is significantly negative, that is to say regional factors can significantly explain the changes of external legitimacy. Model 3 is the addition of mediation variable (external legitimacy) on the basis of model 1. The results show that the correlation between regional factors and acquisition performance is weakened after controlling the variable of external legitimacy ($\beta = -0.58$, the absolute value is less than -0.66 in model 1). Based on the above results, we can see that the three conditions for verifying the mediating role are satisfied. That is to say, the external legitimacy has a significant mediating effect on the regional factors and the acquisition performance, thus hypothesis H1 is supported. Although the results of model 5 show that the correlation between regional factors and acquisition performance is weakened ($\beta = -0.63$, the absolute value is less than -0.66 in model 1) after controlling the variable of internal legitimacy. However, the results of model 4 show the regression coefficients of regional factors and internal legitimacy do not pass the significance test. Therefore, internal legitimacy has no significant mediating effect on regional factors and acquisition performance, thus hypothesis H2 is not supported.

Additionally, we can see from the regression coefficients of the control variables and the acquisition performance that there is a significant negative correlation between state-owned shares of the acquirer, shareholding ratio and relative scale. So we can reach the following conclusions: the higher the proportion of state-owned shares are, the more unfavorable the acquisition performance is. After the acquisition, the higher shareholding ratio the acquirer has, the more unfavorable the acquisition performance is. Before acquisition, the bigger relative scale the acquired enterprise has, the more unfavorable the acquisition performance is. Besides, the regression coefficient of the acquisition experience and acquired enterprise's performance is significantly positive, which shows that the more acquisition experience the acquirer has, the better relative performance the acquired enterprise has and the more favorable the acquisition performance is.

CONCLUSIONS

With the development of our market economy and the increasing competition from multinational enterprises in China, the local cross-regional acquisitions are increasingly more common, which are considered to be an important way of development for enterprises. Its potential theoretical logic is that it can gain economies of scale, economies of scope, complementary effects and learning effects through the expansion of multi-region and multi-market, so as to achieve greater benefits. However, this study found that compared to the acquisitions in the same region, cross-region acquisitions in China did not show significant positive effects on acquisition performance. Through further examination of the intermediary role of legitimacy, we found that external legitimacy plays a significant mediating role between regional variables and performance variables. So to some extent, the low external legitimacy of cross-regional acquisitions is an important reason why cross-regional acquisitions have negative impacts on acquisition performance compared to acquisitions in the same region.

The results of this study confirm that the regional factor of the acquiring and acquired firms significantly affect the acquisition performance of the acquiring firm. In China, there are considerable differences in the institutional environment and regional culture in different regions, so enterprises need to pay considerable costs to overcome obstacles caused by these differences. For example, in a developed region of market economy, the corresponding market system is more perfect, so the development of enterprises relies more on their own competitiveness and management level, but in the underdeveloped regions where the market system is not perfect, the establishment and consolidation of market position may need to be supported by local government or other social relations, and the acquisition of this relationship may need long-term investment and accumulation, therefore, compared to the local enterprises, the foreign enterprises who enter into the market through acquisitions may have a greater disadvantage, which may lead the acquirers to being able to promote the business and expand the market effectively after acquisition. Additionally, because the management from the acquiring enterprise may be unfamiliar with the local market or business, they can't make effective decisions or supervision, and cross-

regional acquisitions will have a certain impact on the control after acquisitions, leading to increased costs of potential opportunism.

This study supports the view of institutional theory, indicating that cross-region acquisitions will be subject to multiple institutional pressures from local stakeholder groups, thus resulting in external legitimacy problems. That is to say, compared to the acquisitions in the same region, acquiring enterprises in cross-regional acquisitions will face a foreign responsibility, they will be given greater expectations to behave well, and the potential costs and risks will be greater if they behave badly. Correspondingly, taking on the foreign responsibility will lead enterprises to invest more resources. Although the empirical results of this study show that cross-regional acquisitions have statistical negative effects on the external legitimacy and acquisition performance, we need to point out that there exist a certain number of successful cross-regional acquisitions. Therefore, in cross-regional acquisitions, enterprise managers should develop a reasonable strategy to obtain as higher external and internal legitimacy as they can, so to offset the lack of legitimacy caused by cross-regional acquisitions, and finally realize the goal of acquisitions.

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