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Chapter X

Product and Market Diversification and the Stock Market Response to Business Combinations: Empirical Evidence from the European Telecommunications Industry

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Abstract

In this chapter, we analyzed the stock market reaction to internationalization and diversification of the European telecom firms through acquisitions or strategic alliances. We analyzed these operations with the purpose of verifying to what extent the stock market reaction to these business combinations is influenced by information asymmetry, resource complementarity, and management costs. There are two main findings of this work. First, while acquisitions are more valued when entering into one of the more related businesses—telecommunication equipment shops—alliances, however, are only positively valued in the less related businesses.

Second, the strength of the competitive position of the firm moderates the relationship between product and market diversification and abnormal returns.

Introduction

There is a vast literature dealing with the stock market reaction to business combinations, that is, strategic alliances or acquisitions (García-Canal, Sánchez-Lorda, & Vidal, 2002). Although both alliances and acquisitions are means to expand firm boundaries into new markets or new countries, this literature is not of much help to identify criteria for choosing between these two entry modes. In fact, its results show that both alliances and acquisitions, aimed at expanding firm boundaries, could generate positive abnormal returns,¹ in other words, they could increase shareholders' wealth. The only existing comparative research that focuses on the stock market reaction in both types of business combinations is the work by Balakrishnan and Koza (1993). They argued and found empirical evidence that when the transaction of the external resource takes place in conditions of information asymmetry, joint ventures are more valuable than acquisitions since they protect the firm from adverse selection problems. However, not all empirical results support this view and some competing explanations—also with partial empirical support—exist. Resource-based theory suggests that when a company gains access to dissimilar resources through acquisitions, more synergies can be expected because the bidder can obtain synergies from the combination of resources that are not easily replicable by other bidders (Harrison, Hitt, Hoskisson, & Ireland, 1991, 2001). In the case of alliances, dissimilar resources open the door to more learning opportunities, but also to more conflicts of interests (Hamel, 1991). Finally, some researchers have highlighted the importance of management costs in organizational combinations (Hennart & Reddy, 1997; Kogut & Singh, 1988). Although potential synergies may exist, the key point to realize these synergies is the capability to fully integrate the target into the organizational structure of the bidder. When some factors exist that make such integrations difficult, this last perspective suggests that strategic alliances would be the preferred entry option.

Given the existence of competing explanations and the lack of conclusive empirical results, we present in this chapter some empirical evidence on the stock market reaction to the organizational combinations carried out by the European telecommunication operators. Ours is an empirical study in which we try to analyze to what extent the stock market reaction to business combinations is influenced by information asymmetry, resource complementarity, or management costs. The interest of focusing on the European telecommunications

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