

On the Choice of Target Firm in International Acquisition

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This paper discusses the choice of an MNC's entry strategy between greenfield investment and acquiring a host firm when there are multiple and heterogeneous targets under acquisition. We focus on the process of selection of the target firm. We construct three games. In a sequential offer game whom to offer first is endogenized. In the bidding game the potential targets simultaneously bid for merger and the highest bidder wins the race. And under repeated offer game there is always the possibility of a new offer by the MNC if the earlier offer is rejected. In the analysis the externality effect of merger under Cournot competition is internalised. Our results show that acquiring the low-productive firm is optimal under acquisition. This clearly contrasts with the results of the other papers discussed in the literature. When the multinational firm chooses to set up a subsidiary, it does so because the reservation payoff of the inefficient firm is not favourable for acquisition as compared to the low level of fixed set up cost. The divergence of technological efficiency also plays a crucial role in the choice between greenfield investment and acquisition. In our paper, foreign firm entry, either in the form of merger or in the form of subsidiary, is always welfare enhancing for the host country.