Unveiling the Role of Political and Legal Frameworks on M&A Dynamics

Lorenzo Panetta

Dissertation written under the supervision of Jose Garcia Revelo

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Abstract

This study investigates the impact of political and legal environments on Merger and Acquisition (M&A) activities across 26 countries over a 22-year period. Utilising a fixed-effects panel data approach, the research incorporates Principal Component Analysis (PCA) to construct composite measures of governance, judicial independence, and property rights. M&A activity, measured both by the number of deals and the total value of deals, is found to be significantly enhanced by solid political and legal frameworks, while high bureaucratic costs and tax burdens deter it. Robustness tests, including the exclusion of US deals, analysis of emerging markets, and lagged models, confirm the consistency of these results. This study uniquely contributes to the literature by employing non-standard proxies and providing nuanced insights into the global M&A landscape, offering a comprehensive understanding of the role played by the institutional and macroeconomic determinants of M&A transactions.

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Súmario

Este estudo investiga o impacto do ambiente político e jurídico nas actividades de Fusões e Aquisições (F&A) em 26 países ao longo de um período de 22 anos. Utilizando uma abordagem de dados de painel com efeitos fixos, a investigação incorpora a Análise de Componentes Principais (ACP) para construir medidas compostas de governação, independência judicial e direitos de propriedade. A atividade de fusões e aquisições, medida pelo número de transacções e pelo valor total das transacções, é significativamente reforçada por quadros políticos e jurídicos sólidos, ao passo que os elevados custos burocráticos e a carga fiscal a desencorajam. Testes de robustez, incluindo a exclusão de transacções nos EUA, a análise de mercados emergentes e modelos desfasados, confirmam a consistência destes resultados. Este estudo contribui de forma única para a literatura, empregando indicadores não normalizados e fornecendo uma visão diferenciada do panorama global das fusões e aquisições, oferecendo uma compreensão abrangente do papel desempenhado pelos determinantes institucionais e macroeconómicos das transacções de fusões e aquisições.

Título: Revelar o papel do quadro político e jurídico na dinâmica das fusões e aquisições

Autor: Lorenzo Panetta

Palavras-chave: Fusões e aquisições, enquadramento político, enquadramento jurídico, APC

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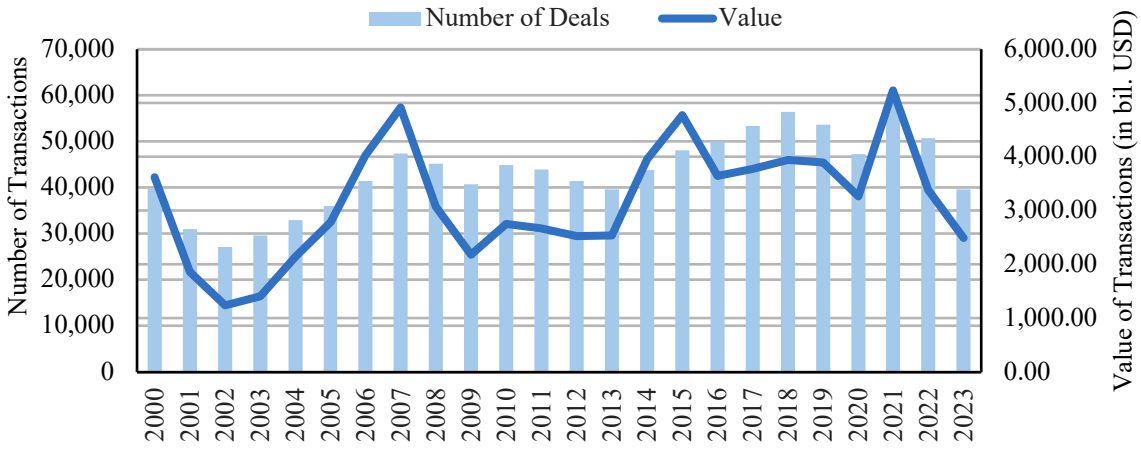
1. Introduction

Merger and Acquisition (M&A) have long been pivotal in shaping corporate scenarios, impacting not only the growth of individual companies but also entire industries' dynamics. Defined as a financial transaction, in which the ownership of a business is transferred or consolidated with another, M&As comprise mergers where two entities combine to form a single company, and acquisitions, where one entity takes over another's assets or capital. Since the 1950s, the Merger and Acquisition processes have become increasingly common and frequent tools for increasing the value of a company, accelerating its growth, changing the original business or acquiring a competitive and strategic position in a specific market segment. Figure 1 shows the global M&A activity between 2000 and 2023, more than 1'040'000 transactions have been announced worldwide with a known value of over 75 trillion USD.

Figure 1: M&A Activity Worldwide



Data have been retrieved from Institute for Mergers, Acquisitions & Alliances (IMAA).
Elaboration of the data made by the author.

Despite this extensive activity, understanding the aggregate impact of country-specific political and legal factors on M&A transactions remains an underexplored area. This study seeks to bridge that gap by examining how taxation, institutional quality, political stability, and regulatory environments influence the volume and value of M&A transactions in 26 countries over a 22-year period. By employing a fixed-effects panel data approach, this research sheds light on the macroeconomic drivers of M&A and provides nuanced insights into the unique legal and political determinants that shape these corporate strategies.

The existing literature identified a cyclical pattern and therefore a wave formation of merger deals across different periods. Martynova and Renneboog (2008) found that merger waves have some common factors such as technological or industrial shocks, and all of these take place in

a positive political and economic context, concurrently with a stock market boom and credit enlargement. Moreover, operations undertaken at the ending period of each wave are often driven by irrational factors, such as market exuberance or conflict of interest. Over the last decades, M&A activity has been subject to constant growth, interrupted by global and local crises, which reduced activities as purely economic factors changed. In addition to these economic factors, the existing literature emphasises that political factors, such as the stability of a state, the quality of its judicial system and the ease of conducting business have emerged as significant determinants of M&A investments.

Given the literature, it can be said that the latter has been exhaustive in identifying factors that can influence M&A operations. However, there is a strong focus on the US context and a lack of aggregate view regarding the interconnectedness of the political and legal environment to the M&A activity. Therefore, this paper aims to contribute to empirical research on the topic of country-specific factors that impact M&A activity by investigating the aggregate effect of taxation, institutional quality, political stability and risk that influence and determine the volume and value of these transactions, through a quantitative fixed-effects panel data approach that has proven to be a valuable tool for explaining M&A activity and, at the same time, taking into account the country-specific unobserved effects that arise among them. The results suggest that solid political and legal frameworks significantly enhance transactional activity, while high bureaucratic costs and tax burdens deter it. The value added of this research is to employ diverse and non-standard variables to better represent the legal and political environment of multiple countries, which are different not only in terms of geography and location but also regarding monetary and fiscal policies applied and economic events experienced, providing a macroeconomics ideal environment that favours and encourages the M&A dynamic.

The paper is structured as follows: Section 2 provides an overview of the current literature regarding the research focus, examining previous findings. Section 3 describes the variables used while Section 4 illustrates the methodology employed. Empirical results are shown in Section 5, followed by robustness tests embedded in Section 6. Lastly, Section 7 encompasses the conclusion paired with Section 8 addressing limitations and suggestions for further research.

2. Literature Review

Until now, many studies and research have been carried out on the impact that various microeconomics and macroeconomics factors can have on the volume and number of Merger and Acquisition (M&A) operations. These factors can influence deeply the occurrence of merger waves. The most recent literature identifies two main theories that bear the phenomenon

of merger wave: Harford (2005) supports the neoclassical economic theory, stating the perfect efficiency of capital markets and the manager's aim of maximizing shareholder wealth.
The second theory, consisting of Shleifer and Vishny (2002) and Gugler and Mueller (2008), takes into account the behaviour of individuals toward capital markets.
Often, these studies also highlight the vastness and complexity of the factors that influence M&A deals. According to Hitt (2006), multiple factors impact the activity of M&A deals such as cultural and geographical differences, specific periods, type of industry-related, legal system and taxonomy and economic factors.
Scott C. Whitaker (2016) identified disparate M&A drivers which may have different influences and classified them into four groups, according to their impact level.
Global-level factors such as the general economic situation, growth indicators and the country's level of development are classified at "meta-level". A tangible example is monetary policy choices adopted by central banks such as Quantitative Easing or Austerity programs.
Changes inside each country (e.g., a new government or the enactment of new laws) are classified as "macro-level".
Factors affecting just a specific industry, such as new technology applicable to the industry or a rise in raw material price, are aggregated at a "meso-level".
Forces associated with certain companies with a direct impact on the surrounding environment, such as a shift in the corporate strategy due to a change in the Board of Directors, are classified as "micro-level".
According to the nature of the research, only factors that fall into the meta and macro level categorization have been considered and, in the next pages, summarised and classified based on the relevant existing literature.

2.1 Economic and Financial Factors

Existing literature widely discussed and tried to identify the economic and financial drivers that can cause a wave or that can favour M&A activity. The interest rate has always been a starting point for academic research and many studies tested macroeconomic variables such as average interest rate, GDP, inflation, treasury bill rate or the level of domestic debt in relation to the level of M&A activity, finding strong explanatory numbers in the investigated period (Becketti, 1986). In particular, Resende (2008) and Choi & Jeon (2011) confirm that variables referring to growth in output, growth in money supply, unemployment rate and stock market returns play a relevant role in conditioning M&A deal volume. Another important economic factor is capital liquidity which, according to Harford (2005), can trigger industry merger waves even if industry

shocks do not happen. Moreover, the liquidity of the company and the availability of capital in the market deeply affect the payment method of the transaction. To finalize the M&A deal the acquirer company can pay in cash, in equity or using a mix of these two. Both methods are linked to macroeconomic factors and the stock market: in fact, the payment method chosen by the acquiring company will be based on the cost of money in the market (in this case interest rates such as Federal Funds Rate, Discount Rate, LIBOR or Euribor play a key role) or on the performance of their stock and therefore on the financial markets. Talking about stock market performance, Ang and Cheng (2003) highlight the importance of stock overvaluation: in particular, this condition increases the possibility of the company being acquired and the probability of exploiting these mispriced stocks as the medium of exchange. This article relates to and directly supports the market-driven acquisitions theory (Shleifer and Vishny, 2002) in which they present a model of M&A based on the stock market's wrong valuation. In addition, Verter (2002) assesses the significant volatility's impact of the market on merger activity.
On the other hand, other researchers found the relation between stock market performance and M&A activity not significant: Always Harford (2005) tested his hypotheses along the behavioural theory and did not find a statistically significant correlation between stock value and the number of deals in M&A; also Gugler and Mueller (2008) checked the influence of the stocks' mispricing and the managerial decisions, found consistency with the behavioural theory but however, the results appear as not significant.

2.2 Legal and Political Factors

Rules and laws regulating a country have a huge impact on its social and economic system. The essence of the law is to establish, clarify and model relationships, and in this case economic relationships. Specifically, a law can protect, forbid, or stimulate these relationships carried out in each country and adapt it to a particular historical period. Jory and Ngo (2011) assert that an efficient legal system should protect intellectual property and enforce the property rights of stakeholders. Moreover, it is demonstrated that a country characterized by weak financial regulation brings a negative impact on foreign activities, including M&A deals (Dikova, Sahib and Witteloostuijn 2008). In addition, the low quality of the legal and institutional system is the leading explanation for the lack of investment from rich to poor countries (Alfaro, Kalemli-Ozcan and Volosovych 2008). Obviously, the institutional and legal system depended on the political choices of the country itself and therefore, implies the consideration of political risk as a determining factor for M&A deals. According to Buttonwood (2017), this risk is associated not only with government manoeuvres which can reduce the investors' expected returns or with

a bad public administration that can cause higher inflation and harm the real economy, but also with social arrest which can cause companies to go bankrupt and can reduce the values of the latter's shares and bonds. According to this evidence, Delios and Henisz (2000) highlighted the fact that investors tend to avoid participating in economic environments characterized by an elevated political risk, except for those countries classified as "emerging markets" in which, despite the high political risk, individuals are willing to invest large amounts of capital, especially in M&A operations (Casson and Lopes, 2013). Finally, the level of domestic debt has always been a benchmark for the country's reliability in terms of financial health: in their study, Dissanayake, Wu, and Zhang (2021) observed that rising government debt correlates with narrower yield spreads between high-grade corporate bonds and long-term Treasury bonds, alongside heightened fiscal uncertainty. This increase in government debt is linked to a decreased likelihood of firms engaging in acquisitions, indicating a significant impact of sovereign financial conditions on corporate acquisition strategies.

2.3 Taxation

Collecting a determined percentage of citizens' income for public expenditure, taxation is a way by which the government regulates part of the economic and social dynamics of a State, trying to reduce the inequality in these two sectors.

Taxation has always been seen as a crucial and determining aspect of the investment process. For investors, taxation constitutes a burden to bear and therefore determines a barrier in the investment allocation process. It is demonstrated (Ang, 2008) that an increase in the development of the financial system and infrastructure of the country and trade openness increase foreign direct investment. However, higher corporate tax and constant appreciation of the real exchange rate, correspond to a disincentive to foreign direct investment. Talking about the effects of taxation on M&A deals, interesting are the results found by Huizinga and Voget (2009). This paper has analysed the impact of the tax burden concerning the numbers of M&A operations from 1985 to 2004 in the European region, Japan and the United States of America. The results highlight that the prospect of double taxation has a negative impact on investments, making them less attractive, and reducing the willingness and the desire to undertake cross-border M&A deals. These findings are also consistent with the literature concerning the effect of tax aggressiveness on shareholders' wealth, in which it is shown that the tax planning of both the acquirer and target company plays an important role in the value creation of an M&A deal (Chow, Klassen and Liu, 2013)

2.4 Time Factor

The literature has extensively investigated the relationship between M&A performance and failure, created by taking advantage of value-added obtained from the synergy of two companies, and the amount of time spent to make the deal. As suggested by Chahine, Hasan and Mazboudi (2018) the deals must be completed in a timely manner. Along with previous statements and with behavioural economic theory, the process of merger or acquisition is undertaken because the target company may be mispriced, and its stocks are traded under the real or estimated value. Thus, the quick accomplishment of the deal, suggests that the lower the stock price, the higher the stimulus for an M&A deal is. At the same time, a relatively long period is required to complete a merger activity due to the process of business evaluation, legal compliance, and due diligence. On this topic, Chahine, Hasan and Mazboudi (2018) highlighted the importance of the role played by auditors in reducing the completion time of the deal. In particular, having a common auditor for both parties increases the deal's completion time and, on the other hand, a strong auditor's experience in M&A reduces accomplishment time and costs. In line with the above paper, Thompson and Changki (2020) found deals that take optimal time, perform better than other deals that take longer. Regarding this aspect, the role played by the free movement of capital and the controls imposed on it is crucial: high levels of capital control, indicating extensive regulation on the flow of capital across borders, can further complicate and slow down M&A transactions, adding another layer of complexity to the already challenging bureaucracy.

As can be seen from the previous pages, the existing literature has stressed extensive and comprehensive research on macroeconomic and microeconomic factors affecting the Merger and Acquisition operations in terms of the deal's volume and value.

As mentioned, the interest rate is the starting point in many research along with the real GDP, GDP growth, and inflation rate. The relation between M&A deals and stock market performance is still under discussion: some research indicates that overvaluation of a company's stock increases the probability that the latter will be acquired and consequently determines an increase in M&A activity during the stock market's positive momentum. On the contrary, different research found no consistency or no significance in the correlation between these two factors.

Last, Sgalippa (2018) suggest that periods of high volatility in the markets are associated with lower M&A activity and also lower returns for bidding firms.

Considering the completion time as a factor increasing the value of the M&A deal, the literature found that greater experience and expertise, associated with a shorter time to complete due diligence practices lead to a positive value creation after the completion of the operation.
Moreover, the legal environment and the political stability play an important role in shaping the number of M&A operations, and the related value, carried out in a particular country.
The political stability of a country seems to be a decisive factor, especially in the cross-border merging activity, which is negatively correlated with this latter when a country is considered politically unstable except for emerging markets, where investors are willing to bear greater risk. Last, taxation has a huge influence on the decision to undertake this type of operation, especially in cross-border mergers in which there is also the disincentive of double taxation.
This paper contributes to the current literature by encompassing a novel approach to analyse the impact of political and legal country-specific factors on M&A activity. Different from previous studies, this research employs a Principal Component Analysis (PCA) to obtain a composite measure of the country's political and legal scenarios, using alternative variables to proxy these factors such as government integrity, effectiveness, judicial independence, and property rights. This approach helps in enhancing the reliability of the models and addressing the complexities and interconnection of the variables affecting M&A transactions, providing a robust and deeper understating of political and legal frameworks' impact on M&A activity on a global level at different time periods.

2.5 Hypothesis Formulation

Along with the above examination of the current literature, two hypotheses have been developed. Considering that the M&A activity is a corporate investment decision pursued towards various reasons such as market expansion, consolidation or vertical and horizontal integration of the value chain, it is immediate to assume that a favourable economic environment characterized by cheap found sources, positive real economic growth outlook and flourishing capital markets can encourage and favour the activities. However, after careful thought, the economic environment is only one factor that must be paired with multiple country-specific characteristics which make these latter attractive for both domestic and foreign investments. Specifically, political and legal frameworks play a key role in shaping the appeal of the country for investment, aiming to create an accommodative environment that incentivizes the flow of capital enhancing future economic prosperity.
In this context, the integrity and reliability of the government in charge, in terms of commitment to policy implementation and law enactment, is crucial to forming a stable environment and

stimulating investments from companies that are seeking opportunities of return in a predictive and non-turbulent context. Considering that the legal framework is crucial for every individual who wants to invest or make a deal in a specific country, companies may undertake an acquisition to become owners of patented technologies or acquire niche know-how that could lead to superior performance and therefore, it is crucial that an impartial judiciary environment, not subject to third-party influences, is able to rule legislation that protects the legal entitlement of companies. This leads to the formulation of the first hypothesis:

H1: the government stability and reliability, paired with an effective and independent judiciary favour the M&A activity.

However, a strong and articulated legal environment could inversely affect M&A activities by making them costly and protracted, thus discouraging companies' investment intentions. Precisely in this scenario, factors such as the weight of bureaucracy, the ease of capital flow and tax burden, being essential elements that represent and characterise the legislative framework of a country, play a pivotal role in determining the level of investments in that nation, bringing to the second hypothesis formulation:

H2: a restrictive regulatory environment decreases M&A activity.

3. Data

3.1 Data Specification

According to the nature of the research, is it possible to divide data into two main categories: The first one, includes the data relative to the Merger and Acquisition activity, which will be used as the dependent variables of the analysis. On the other hand, different indicators related to country-specific political and legal environment, along with economics variables, will take the place of independent variables, with the aim of explaining, with a certain degree of significance, the impact these have had and have on the M&A activity across the selected countries.

The geographical extension of the research has reached twenty-six (26) countries in total, covering the most relevant advanced and emerging economies in the world, ensuring relevant differences and heterogeneity across the independent variables selected. Specifically, Austria, Belgium, Finland, France, Germany, Ireland, Italy, Netherlands, Norway, Poland, Portugal, Spain, Sweden, Switzerland and the United Kingdom have been selected for the European region; Argentina, Brazil, Canada, Mexico and the United States of for the America region;

Australia, China, India, Japan and Russia for the Asian-Pacific region; and for the African's one South Africa is the only represented. Regarding the period examined, the longest timeframe has been considered according to data availability, in order to capture different legal, political and economic scenarios to ensure heterogeneity. In particular, the analysis focuses on a twenty-two (22) year period ranging from January 1st 2000 to December 31st 2021. The above-mentioned conditions lay the foundation for panel data, including the following variables.

M&A Activity

M&A data has been collected from the Refinitiv Eikon (Thomson Reuters) terminal database satisfying the following criteria:

1. Announcement Date included from January 1st 2000 to December 31st 2021.
2. Deal Status tagged as "Complete".
3. Transaction type classified as "Disclosed Dollar Value".
4. Deal Value above or equal to 1 million US Dollars.
5. Acquired company Nation strictly among the 26 countries mentioned above.

According to Eikon, the dataset includes 166,105 deals across a period of twenty-two years in the twenty-six selected countries, split into annual observations and aggregated per country. The date taken as reference is the "announcement date" of the deal, as it is a more reliable proxy to identify the period in which the operation occurs compared to the completion date. In fact, M&A operations take months to be completed thus, the announcement date better reflects the current political and economic scenario. Additionally, only the completed deals with a relative value above one million US Dollars disclosed have been considered.

The M&A activity has been aggregated in two ways: the natural logarithm of the number of transactions that occurred in each year per country and the natural logarithm of the total value of the deals, always according to the relative year and country. This finds consistency in the pioneer study of Becketti (1986), in which the effects of different macroeconomic variables are tested both against the deal's value and the number of transactions that occurred in a period. Considering that the method has become the norm in recent papers, I decided to include both measures as proxies to better capture the overall activity and its magnitude.

Legal Variables

The legal framework in which companies operate influence significantly affects their activities and therefore the M&A-related domain. "Economic Freedom of the World - 2022" written by Fraser Institute offers great insights into the legal environment of each country and its

development across time. According to this source, four main variables have been identified and included in the analysis:

Judicial Independence: As reported by the explanatory notes, the variable defines the extent to which a country's judiciary system is independent of political branches, citizens and firms: this independence ensures impartial legal and contractual rights, enhancing investor confidence. The value ranges from zero to ten scale: the higher the score the more independent the judicial framework is.

Property Rights: defined as, the legal entitlement to use, control and exploit an asset. As stressed by Jory and Ngo (2011) an efficient legal system should enforce and protect the latter, ensuring ownership and transferability of assets, lowering transactional risk and thus, incentivising M&A activity in the country. The value ranges from zero to ten scale: the higher the score the clearer the property rights are defined.

Bureaucracy Costs: the component, measures the risk that companies' operations become costly according to the regulation environment. In particular, higher bureaucracy costs involve higher regulatory compliance and transactional expenses, inhibiting M&A activity. Conversely, a streamlined regulatory framework lowers those costs, making a country more attractive. The values range from zero-to-ten scale, with a higher value indicating greater costs.

Capital Control: the variable is defined as all those regulatory measures that restrict financial capital and foreign investment flows across borders. This will be our time proxy, considering that an easier flow of capital inside the country, notably reduces the time to complete the deals, favouring the latter. The statistic is based on 13 components and is expressed on a zero-to-ten scale, where a higher score indicates a higher percentage of capital control not levied over the total number of controls listed. Therefore, the higher the score, the less stringent are capital control policies, enhancing the country's investment attractiveness.

Political Variables

As determinants of M&A activity, political variables often play a similarly critical role as legal ones. With a greater extent in cross-border M&A activity, three additional governance indicators have been identified to elucidate the impact of competence, operational capacities and ethical level of government in charge that may have on the transactions' activity. The following section draws one indicator from the "Index of Economic Freedom 2023" written by the Heritage Foundation, one from the World Bank Database and the last one from the "Corporate Tax Rates around the World, 2023" report published by Tax Foundation:

Government Integrity: interpreted as the extent to which public power is not exercised for private gains, including different forms of corruption, as well as the related anti-corruption measures. This principle embeds the ethical quality and honesty of public bodies and how faithful they are towards good government principles. The scores range from a zero to ten scale, where a higher score reflects higher government integrity.

Government Effectiveness: according to the definition provided by the World Bank, the variable conveys perceptions regarding the quality of public services, the competence of the civil service, its insulation from undue political influence and encompasses the government's capability in policy formulation and execution, along with its commitment to such policies. The values range from a zero to ten scale: the higher the score the better the environment for M&A activity, ensuring reliability in an efficient public service.

Corporate Tax Rate: consisting of the percentage of corporate profits that businesses must pay to the government, the tax burden can deter M&A activity. As reported by the Tax Foundation in the " Corporate Tax Rates around the World, 2023" it measures the proportion of corporate income that goes to taxes. The value is expressed in percentage of the profit reported, with a higher value indicating a higher tax rate, that may act as a deterrent due to the increased cost of doing business.

Economic Variables

As already stressed by existing literature, economic variables play a pivotal role in shaping the direction of investment flows and have a deep impact on the M&A activity landscape across different countries. Therefore, the assessment of these variables has become standard in the analysis of the macroeconomics landscape against the M&A trends, enabling to gauging of a comprehensive picture of the economic situation of a nation at a specific point in time.

Real GDP Growth: reflecting the overall economic health, it indicates the pace at which a country's economy is growing, net to inflation. A sustained GDP growth rate is a positive signal of a robust economy, facilitating M&A activity. The variable is measured as the percentual change over the previous period on annual frequency, from "World Economic Outlook 2023" by the International Monetary Fund.

Inflation: intended as the rate at which the general level of prices for goods and services rose, the inflation data, taken from the World Bank Database, are expressed as the annual percentage change over the previous year, based on the Consumer Price Index. In the M&A context, stable and low inflation is preferred, signalling a stable economic environment.

General Government Debt: defined by the International Monetary Fund as the total stock of debt liabilities issued by the general government as a percentage of GDP, the level of debt has always been a reliable indicator of a country's fiscal health, with a higher level implying economic uncertainty, possible future increase in tax burden or cut in public spending. Related to M&A activity, it has been demonstrated that an increase in government debt, decreases the likelihood of companies undertaking deals.

Central Bank Interest Rate: often referred to as the benchmark rate, the policy rate is an important instrument used by central banks to implement their monetary policy, directly influencing the cost of borrowing money. Considering that M&A transactions often rely on debt to be financed, low interest rates can reduce the cost of capital, encouraging companies to pursue growth through acquisitions. The data comes from the BIS Data Portal, on a non-seasonally adjusted monthly basis.

Stock Market Performance: based on the annualised MSCI equity index of each country, except for MOEX in Russia and S&P500 in the United States (retrieved from Eikon Datastream), the performance of a country's stock market often reflects the confidence and the expectation that investors have in its growth prospects. The relationship between this factor against the M&A activity is still an open debate, considering that bullish markets with rising stock prices can drive up company valuations, making M&A transactions more expensive but potentially more lucrative or incentivising transactions based on a market exuberance sentiment.

Stock Market Volatility: based on the same source of the variable above, market volatility has always been a proxy for uncertainty about future economic conditions, affecting M&A activity. High volatility can lead to a wait-and-see approach, potentially slowing down deal-making. Conversely, periods of low volatility provide a more predictable environment that may encourage M&A as companies can better forecast the outcomes of their investment decisions.

3.2 Data Harmonization & Manipulation

To understand the relationship of M&A dynamics with political and legal environments across different countries, a necessary precursor to the empirical analysis consisting of data manipulation and harmonisation is needed, ensuring consistency and comparability across datasets and setting the stage for robust empirical analysis and straightforward interpretation.

The first data manipulation of the dataset focused on outliers' identification of the M&A transactions, based on the associated disclosed amount, particularly those that could potentially skew the analysis. This entailed the exclusion of extreme data points that fall outside the

interquantile range defined by the 1st and 99th percentiles of M&A deal value, expressed in US Million Dollars. This methodology was performed through Excel, and underpinned by the principle that extreme values, while representative of real transactions, could disproportionately influence the statistical analysis and potentially lead to skewed interpretations of the underlying trends. The idea of excluding, rather than replacing, observations lays its foundations of preserving data's core central tendency and variance as a genuine representation of the M&A activity, finding consistency in the literature. The application of the above-mentioned methodology led to the identification of 3,868 transactions labelled as outliers that have been excluded from the dataset, reducing the total number of deals from 166,105 to 162,237. Afterwards, the data was organized according to two metrics to assess the M&A activity: extensive and intensive margins. The extensive margin represents the total number of transactions occurring within a specific country and year, while the intensive margin denotes the aggregated value of these transactions for each country-year observation. The natural logarithm of these values was applied, according to the reduction of the variables' standard deviation (as shown in Table 1) that the transformation led to, facilitating the empirical analysis and considering that it is a widely tested and recognised method in economic research for compressing data scale, especially related to variables that show non-linear relationships.

Table 1: M&A activity - Descriptive Statistics

	Obs	Mean	Std. Dev.	Min	Max
num_deals	572	283.631	518.511	7	3647
value_deals	572	48473.24	134772.17	230.597	1457642.1
ln_num_deals	572	4.741	1.265	1.946	8.202
ln_value_deals	572	9.547	1.479	5.441	14.192

Moving to the independent variables, those categorized as "political" and coming from the "Index of Economic Freedom 2023" written by the Heritage Foundation and from the World Bank Database presented a non-zero-to-ten scale and therefore have been adjusted respectively. In particular, "Government Integrity" and "Tax Burden", disclosed by the Heritage Foundation are presented on a zero-to-hundred scale, therefore each value has been divided by ten (10) for harmonisation purposes. Similarly, "Government Effectiveness" from the World Bank is represented on a scale ranging from -2.5 to +2.5, and each value was harmonised with the following formula to ensure consistency:

$$Harmonised\ value = \frac{Value + 2.5}{5} * 10$$

Aggregation treatment has been applied to the "Central Bank Interest Rate" variable, provided monthly by the Bank for International Settlements (BIS). The annualization of the rates, simply based on the average of the monthly reading per year and country, was a must to propose a meaningful measure, given that central banks adjust policy rates according to the evolution of the economic landscape rather than at fixed and predefined intervals.

Lastly, is important to disclose how "Stock Market Performance" and "Stock Market Volatility" variables have been constructed according to the raw data. First, the MSCI Equity Index of each country were identified and the respective daily price of each has been extrapolated through Datastream, except Russia and the United States for which MOEX and S&P500 Composite Index have been considered respectively. The choice of the same source, as a proxy of the country's stock market performance, ensures consistency over the criteria selection applied to construct and rebalance each index over time. Then, the daily return of each index has been calculated as shown:

$$ln(R_{i,d}) = ln\left(\frac{P_{i,d}}{P_{i,d-1}}\right)$$

where: ln represents the natural logarithm, $P_{i,d}$ is the price of an index "i" at a time "d", and $P_{i,d-1}$ represents the price of an index "i" on the previous day. Afterwards, the following formula has been used to compute the annualised average return of each index in the relative year:

$$\bar{R}_{i,t} = e^{\left(\frac{1}{N_i}\sum_{t=1}^{N_i} ln(R_{i,d})*252\right)} - 1$$

Similarly, the historical annualised volatility has been computed per country and relative year, according to the daily returns of each index with the following formula:

$$\sigma_{i,t\ annualised} = \sigma_{i,t} * \sqrt{252} = \sqrt{\frac{1}{N_i - 1}\sum_{t=1}^{N_i}(R_{i,d} - \bar{R}_{i,t})^2} * \sqrt{252}$$

where: σ represents the historical volatility obtained through the annualization of the historical standard deviation of the daily returns in the sample observed.

As shown in Table 2, a high degree of correlation is found among political and legal variables, especially between government integrity, government effectiveness, judicial independence and property rights. It is straightforward the fact that in a country in which the integrity of the government is higher, there is a clear distinction between the political and legal powers, leading to a high degree of judicial independence. Consistently, a more integer government is often associated with an above-average degree of effectiveness, intended as the government's capability in policy formulation and execution, along with its commitment to such policies.

Lastly, the correlation matrix indicated that countries displaying higher government ability in law formulation and implementation, have cleared and better-defined property rights law.

Table 2: Pairwise correlations – Political & Legal Variables

	(1)	(2)	(3)
(1) gov_int	1.000		
(2) gov_eff	0.950	1.000	
(3) jud_ind	0.876	0.875	1.000
(4) prop_ri	0.921	0.939	0.901

Taking into account these four highly correlated variables and the functionality of performing the statistical analysis with a minimal number of variables, I decided to generate a composite measure combining the above-mentioned variables through a Principal Component Analysis (PCA). This technique is not uncommon finding consistency in previous papers that analyse the M&A landscape, such as Kalsie & Singh (2022) and it is useful to deal with a potential multicollinearity problem given by the application of multiple correlated variables and, considering that multiple variables are affected, it's a wise procedure to compress and merge these latter into a single component. Therefore, the PCA is performed on the mentioned variables (gov_int, gov_eff, jud_ind, prop_ri) according to the country of reference and a score has been predicted based on entity and time, obtaining a new composite variable denominate "pl_PCA". Note that only the components with an associated "eigen" value above the level of 1 have been considered, since their strong explanatory power. Table 12 shows the weight attributed to each component in constructing the variable and the associated sample adequacy measured through the Kaiser-Meyer-Olkin (KMO) test. The high correlation of the variables should be enough such that, the predicted variable will explain the bulk of the variance. This PCA theoretical fundamental goes along with the stationarity of the selected variables, that's why a unit root test Fisher-type has been performed prior to the PCA analysis as suggested by Choi (2001), resulting in a stationarity of the analysed variables. Finally, the Kaiser-Meyer-Olkin test is run per each score country's score prediction to measure the sampling adequacy of each variable, measuring the proportion of variance among variables that may be common among these. A resulting KMO value above 0.5 is considered a reliable proportion to determine the suitability of the variables in factor analysis.

Lastly, according to the occurrences that happened in the last years, I decided to drop Argentina's observations considering the deviation of interest rate and inflation means compared to the other countries, which could clearly bias the analysis.

4. Methodology

With the aim of evaluating the relationship between the political and legal environment of the M&A activity in different countries, the methodology adopts an empirical approach, grounded on the principles of panel data regression analysis, paired with fixed effect modelling. Panel data regression, due to its dual dimensionality, allows the observation of multiple countries across time, providing a comprehensive dataset that captures both the temporal and cross-sectional variations inherent in M&A activities. This methodology is particularly suited to dealing with omitted variables bias due to the heterogeneity provided by the data itself. Additionally, fixed effects models are instrumental in this analysis, as they enable to control of unobservable variables that could potentially bias the results. By focusing on the variation within countries over time, fixed effects models help isolate the impact of political and legal variables on M&A activity from other confounding factors. This approach is pivotal and well-established among academics, when assessing the influence of governance quality, regulatory frameworks, and economic policies, as it accounts for the inherent differences across countries and over the years.

The use of the fixed effect is backed by the performance of the Durbin-Wu-Hausmann test; it is a widely used method in economic research when dealing with panel data to evaluate the consistency of an estimator compared to an alternative, less efficient one. In this case, the consistency of the fixed effect estimator is compared to the random effect. Specifically, as a first step, I run the above-mentioned regression, without including control variables, with the fixed effect specification. Note, that in order to perform the test, we do not control for heteroskedasticity, as a test requirement. Afterwards, the same regression was run and stored, controlling for random effect. Lastly, the two estimators are compared through the Hausmann test in Stata, under the null hypothesis that the difference in the estimation coefficients is not systematic. Obtaining a probability of chi-square that is less than 0.05 we can reject the null hypothesis, suggesting a statistical difference in the consistency of the two estimators, backing the choice of using a fixed effect model. The same methodology has been performed including economic control variables and again, the rejection of the null hypothesis confirms what we have previously stated.

Multiple regressions have been carried out to analyse the impact of the country's political and legal environment on the related M&A activity observed at a specific time. To begin, the natural logarithm of the number of deals was tested against the PCA-generated components and the remaining three variables, representing taxation level, level of capital controls and bureaucracy cost, including also entity and time fixed effect. Along with that, the same regression has been

performed against the natural logarithm of the total value of the deals, in order to capture the influence of the independent variables also on the magnitude of the M&A activity, providing a more comprehensive picture. Consequently, both regressions have been controlled for macroeconomic variables that may influence firms' M&A activity such as GDP growth, central bank interest rates and stock market returns and volatility, among others.

4.1 Empirical Model Specification

The study uses panel data analysis to explore the country-level components related to the political and legal environment of M&A activity. To begin, simple panel regression without economic control variables was run, and after that country fixed effect and dummy variable representing crisis years were added. Note that the same independent variables have been tested twice: first, on the total number of deals and then on the aggregated value of deals, using the following models specific:

$$ln(num\ M\&A_{i,t}) = \alpha + \beta_1 pl\ PCA_{i,t} + \beta_2 tax_{i,t} + \beta_3 cap\ contr_{i,t} + \beta_4 bureau\ cost_{i,t} + \varepsilon_{i,t}$$

where i denotes the country and t denotes the year reference.

In this model, the dependent variable is defined as:

- $num\ M\&A_{i,t}$: the total number of mergers and acquisitions that occurred in a country i at year t.

The independent variables are defined as:

- $pl\ PCA_{i,t}$: a PCA variable proxying the political and legal frameworks in a country i at year t.
- $tax_{i,t}$: the corporate tax rate in a country i at year t.
- $cap\ contr_{i,t}$: the percentage of capital control not levied over the total number of controls listed in a country i at year t.
- $bureau\ cost_{i,t}$: the cost of the regulatory environment for firms' operation in a country i at year t.
- $\varepsilon_{i,t}$: the idiosyncratic error term in a country i at year t.

The same independent variables have been tested on the value of the deals, obtaining a second model, specified as:

$$ln\ (value\ M\&A_{i,t}) = \alpha + \beta_1 pl\ PCA_{i,t} + \beta_2 tax_{i,t} + \beta_3 cap\ contr_{i,t} + \beta_4 bureau\ cost_{i,t} + \varepsilon_{i,t}$$

in which the dependent variable is defined as:

- $value\ M\&A_{i,t}$: the sum of the value of mergers and acquisitions that occurred in a country i at year t.

As highlighted in previous research, the economic environment plays a pivotal role in assessing M&A activity across different countries and therefore, it is crucial to include multiple variables to proxy the economic framework of each country analysed in each specific period. To account for that the above-presented models have been extended, controlling for economic variables, obtaining the following regressions:

$$ln(num\ M\&A_{i,t}) = \alpha + \beta_1 pl\ PCA_{i,t} + \beta_2 tax_{i,t} + \beta_3 cap\ contr_{i,t} + \beta_4 bureau\ cost_{i,t} + \beta_5 GDP\ grw_{i,t} + \beta_6 inf_{i,t} + \beta_7 debt_{i,t} + \beta_8 int\ rate_{i,t} + \beta_9 mkt\ ret_{i,t} + \beta_{10} mkt\ vol_{i,t} + \beta_{11} d\ crisis_t + \lambda_i + \varepsilon_{i,t}$$

$$ln(value\ M\&A_{i,t}) = \alpha + \beta_1 pl\ PCA_{i,t} + \beta_2 tax_{i,t} + \beta_3 cap\ contr_{i,t} + \beta_4 bureau\ cost_{i,t} + \beta_5 GDP\ grw_{i,t} + \beta_6 inf_{i,t} + \beta_7 debt_{i,t} + \beta_8 int\ rate_{i,t} + \beta_9 mkt\ ret_{i,t} + \beta_{10} mkt\ vol_{i,t} + \beta_{11} d\ crisis_t + \lambda_i + \varepsilon_{i,t}$$

in which the control variables are defined as:

- $GDP\ grw_{i,t}$: the annual percentage of Real GDP growth in a country i at year t.
- $inf_{i,t}$: the annual inflation in a country i at year t.
- $debt_{i,t}$: the total government debt as a percentage of GDP of a country i at year t.
- $int\ rate_{i,t}$: the central bank interest rate of a country i at year t.
- $mkt\ ret_{i,t}$: the average annual performance of the stock market of a country i at year t
- $mkt\ vol_{i,t}$: the average annual volatility of the stock market of a country i at year t.
- $d\ crisis_t$: a dummy variable, taking the value of 1 if the year t assumes the value marked as a global recession period from the Business Cycle Dating research, published by the National Bureau of Economic Research.
- λ_i: the unobserved time-invariant fixed effect unique to each country i.

4.2 Expected Sign of the Variables

According to the literature review and critical thinking proposed in the previous sections to support the hypotheses developed, Table 3 summarises the expected signs of the independent variables' coefficients that will be tested according to the proposed models. The main variable of the analysis, proxying the government effectiveness and the quality of the judicial system, is

expected to show a positive sign along with hypothesis 1 that a stable and reliable political and judiciary system enhances companies' confidence toward the country, fostering the M&A activity. The same positive sign is expected by the capital control variable, considering that less stringent control over capital flows should smooth operations, reducing costs. An opposite effect should be observed on the taxation and bureaucracy cost variables if we consider that, in countries characterised by higher tax burdens and complex bureaucracy, these factors tend to shrink companies' profitability thus, leading to a less appealing acquisition. Moving to the control variables, a positive coefficient is expected for the GDP growth since it is a good indicator of a country's economic health and therefore a running economy is associated with a positive business cycle, leading to an increase in the transaction activity. A negative sign is expected for the government's debt, interest rates and market volatility: as highlighted in the literature, high government debt is often associated with a riskier country perception and therefore a less palatable investment opportunity. Similar is the effect of the market volatility that brings uncertainty to individuals. Along with that, considering that M&A deals are often financed by debt, higher interest rates increase the cost of capital for the transactions, discouraging the overall activity. Lastly, more ambiguous is the effect of market returns and inflation: positive market return can have a positive effect on the M&A activity because a possible appreciation of the acquirer's shares makes the acquisition more attractive, especially if they are part of the payment method. Conversely, an overvaluation of the target company tends to increase the enterprise value of the latter, turning the transaction costly. Similar to this is the effect of inflation, which could be better if the uncertainty and the spending capacity reduction related are considered but it could also boost companies' revenue, especially the one that operates in certain sectors, leading to larger space for M&A activity due to higher cash availability.

Table 3: Variables and relative expected signs

Variable	Expected sign
pl_PCA	+
tax	-
cap_contr	+
burea_cost	-
gdp_grw	+
infl	+/-
debt	-
int_rate	-
mkt_ret	+/-
mkt_vol	-

5. Empirical Findings

5.1 Statistical Summary

The main findings of the models proposed above are shown and illustrated in this section, with a brief introduction of the analysis focusing on the variables' key statistics. Table 4 shows the summary statistics of dependent and independent variables that compose the models. The M&A activity, measured both through the number of deals and the aggregate value of deals, presents a high standard deviation of 526 and 137'113, respectively in contrast with their natural logarithms which present a standard deviation close to 1. Additionally, the natural logarithm transformation improved also the skewness and kurtosis of these variables: specifically, a positive skewness (3.4 and 5.7), suggesting a smaller number of deals and related value in different countries in different periods, and a leptokurtic distribution (15.3 and 40.1), indicating heavy tails presence and greater likelihood of extreme events, have been replaced by lower values indicating more data symmetry (skew of 0.5 and 0.3) and a mesokurtic distribution (Kurt of 2.8 and 2.3), strengthening the reasoning behind the need of a logarithm transformation. The main independent variable "pl_PCA" has a mean of 0 and a standard deviation of 1.4, highlighting the correct construction of the instrument and ensuring considerable variation within the sample. The remaining independent variables show a quasi-symmetric data distribution with values ranging between -0.4 and 0.1 and a slight platykurtic distribution with values below 3, indicating a thin tail, stretched around the centre. Moving to the economic and financial control variables, which include GDP growth, inflation, debt, interest rates, market return and market volatility have mean values of 0.02, 0.02, 0.7, 0.03, 0.05 and 0.21 respectively, and present relatively low standard deviation. Additionally, all the variables display slightly positive skewness suggesting a long right tail, in line with the expectation for economic indicators. Lastly, all the control variables display leptokurtic distribution with values ranging from 4.8 to 13.1, suggesting peaked distribution possesses thick tails that, in this framework, are expected due to the nature of the variables.

Table 4: Descriptive Statistics

Variable	Mean	Std. Dev.	Min	Max	Skewness	Kurtosis
num_deals	293.86	526.207	7	3647	3.396	15.295
ln_num_deals	4.803	1.247	1.946	8.202	0.529	2.856
value_deals	50343.132	137113.97	362.643	1457642.1	5.670	40.139
ln_value_deals	9.644	1.415	5.893	14.192	0.353	3.346
pl_PCA	0	1.437	-4.424	3.141	-0.309	2.720
tax	29.011	6.62	12.5	52.03	-0.288	2.936
cap_contr	4.774	2.495	0.769	9.231	0.117	1.889
burea_cost	6.463	2.092	0.372	10	-0.400	2.219
gdp_grw	0.024	0.034	-0.112	0.245	0.200	7.822
infl	0.024	0.021	-0.045	0.147	1.485	7.377
debt	0.69	0.403	0.074	2.587	1.743	7.585
int_rate	0.031	0.04	-0.007	0.32	2.600	13.121
mkt_ret	0.056	0.228	-0.699	1.152	0.080	4.872
mkt_vol	0.208	0.091	0.066	0.696	1.536	6.501

Table 5 reports the Pearson correlation between the models' variables. Confirming what has been mentioned in the previous section, a high correlation between government integrity and government effectiveness (0.948) is observed, underscoring that countries perceived to have higher levels of government integrity tend to exhibit more effective governance. Similarly, this correlation is seen also among judicial independence and property rights variables with respect to government integrity and effectiveness, with coefficients well above 0.85, suggesting a cohesive legal framework and superior governance coexist harmoniously. Given that, there is a justified rationale beyond the Principal Analysis Component application, serving to reduce multicollinearity problems, leading to a model simplification in variables' number and enhancing results interpretability. Additionally, notable correlations can be found among inflation and interest rates, which exhibit negative coefficients with government integrity and effectiveness, with values of -0.427 to -0.457 and -0.567 to -0.584, respectively. This repeated negative relationship indicates that higher inflation and interest rates may prevail in environments characterized by less effective governance with reduced integrity. The table also suggests that increased uncertainty in the financial markets, measured through volatility, tends to reduce the M&A activity, as highlighted by the negative relationship of -0.133 and -0.179 between volatility, number of deals and value of deals, respectively.

Table 5: Pairwise correlation

Variable	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)
(1) ln_num_deals	1.000														
(2) ln_value_deals	0.881	1.000													
(3) gov_int	0.067	0.176	1.000												
(4) gov_eff	0.055	0.157	0.948	1.000											
(5) jud_ind	-0.023	0.072	0.865	0.863	1.000										
(6) prop_ri	0.048	0.176	0.920	0.942	0.886	1.000									
(7) pl_PCA	0.079	0.082	0.072	0.101	0.116	0.131	1.000								
(8) tax	0.302	0.256	-0.158	-0.089	-0.045	-0.044	0.004	1.000							
(9) cap_contr	0.094	0.157	0.368	0.410	0.378	0.421	0.024	0.084	1.000						
(10) burea_cost	0.000	0.069	0.396	0.438	0.366	0.425	-0.163	-0.138	0.244	1.000					
(11) gdp_grw	0.128	0.016	-0.240	-0.216	-0.235	-0.252	0.042	-0.056	-0.121	-0.065	1.000				
(12) infl	-0.048	-0.102	-0.427	-0.457	-0.251	-0.417	0.063	0.210	-0.206	-0.350	0.232	1.000			
(13) debt	0.157	0.164	0.073	0.108	0.115	0.196	-0.081	0.291	0.323	0.282	-0.254	-0.247	1.000		
(14) int_rate	-0.044	-0.125	-0.567	-0.584	-0.528	-0.565	0.067	0.147	-0.203	-0.408	0.252	0.541	-0.345	1.000	
(15) mkt_ret	-0.017	-0.012	-0.121	-0.138	-0.121	-0.132	0.011	-0.022	-0.089	-0.078	0.108	-0.017	-0.060	0.076	1.000
(16) mkt_vol	-0.133	-0.179	-0.128	-0.142	-0.166	-0.152	-0.067	0.001	-0.030	-0.215	-0.160	0.103	-0.041	0.264	-0.414

5.2 Empirical Results

The main findings of the models proposed are presented in the following section, Specifically, Table 6 reports the outcome of the first model in which political and legal factors are tested, also under a fixed effect model, on the M&A activity, measured as the number of deals. Table 7 reports the second model, in which the same independent variables are evaluated on the M&A activity, aggregated as the total value of the deals.

5.2.1 Model 1 – Political and legal environment effects on the number of M&A deals

The results of the first model are presented in Table 6. The table shows 4 regressions, starting from a simple plain model that includes only political and legal variables to a more comprehensive one, including economic control variables, country fixed effect and a dummy variable for crisis years. Specifically, regression one includes a simple regression with no control variables, which are included in the second regression while the third regression considers the impact of country-specific fixed effect. The fourth regression includes all the variables previously mentioned paired with an individual fixed effect and a dummy crisis variable, reflecting the previously cited model specification. The sign of the coefficients of the variables included in this model are aligned with the expectation stated above and are consistently significant in every regression proposed. In particular, focusing on the last regression that reflects the model specifications, the main Principal Component Analysis variable "pl_PCA", which is used as a proxy for government integrity, effectiveness, judicial independence and property rights, shows a positive coefficient in relation to the M&A activity, measured as the numbers of deals, that is statistically significant at 5% level. Specifically, with a coefficient of 0.059, the effect of a unit increase in the PCA variable leads to a 5.9% change in the number of M&A deals. Thus, a first suggestion is that a solid governance framework, characterized by higher integrity and an efficient legal system that clearly defines and protects the intellectual and property rights of the private sector, tends to enhance and incentivize M&A activity. This first result goes along and supports hypotheses 1 suggesting that a stable and predictive political and legal environment fosters investment decisions and, finds consistency with the literature examined, specifically with Dikova, Sahib and Witteloostuijn (2008), indicating that countries characterized by a weak regulation led to a negative impact the M&A activity, and Jory and Ngo (2011). The second variable that shows statistical significance at 10% level is bureaucracy cost, depicting a negative coefficient of -0.023, in line with the expectations of hypotheses 2 that higher regulatory and compliance costs curb the M&A

activity given the increased complexity and the cost of the latter, specifically of -2.3% change given one unit increase in the independent variable. Moving to the other variables, it's notable to mention that the signs of the factors are in line with the expectations, supporting both the hypotheses formulated and the literature, keeping in mind that none of these variables show statistical significance. Specifically, taxation appears to negatively influence the M&A activity, highlighting the inhibitive effect of a higher tax burden on corporate deals. Also, the coefficients shown by the capital control variable enhance the positive correlation between the percentage of controls not levied and the transactions' activity, emphasising that less stringent capital control policies enhance the country's investment attractiveness. Shifting the focus to the control variables, is it possible to observe that GDP growth, with a consistently positive and statically significant coefficient at a 1% level, favours the M&A activity again in line with the expectation and the literature consulted. Opposite is the effect of central banks' interest rates, which clearly reduce the transaction activity: specifically, a rise in the interest rates leads to an increase in the financing cost of the deal, considering that most of the transactions are based on a relatively complex payment structure that relies also on debt financing most of the time. Lastly, a negative effect of the market return is highlighted and may be associated with the fact that a bull market implies an appreciation of companies' stock price that increases thus making the cost of the acquisition more onerous.

Table 6: Model 1 - Regressions Results

	ln_num_deals	ln_num_deals	ln_num_deals	ln_num_deals
Constant	5.053***	5.258***	5.323***	5.293***
	(0.396)	(0.321)	(0.184)	(0.176)
pl_PCA	0.066***	0.06***	0.059**	0.059**
	(0.021)	(0.022)	(0.022)	(0.022)
tax	-0.01	-0.006	-0.008	-0.007
	(0.012)	(0.01)	(0.01)	(0.009)
cap_contr	0.024	0.024	0.024	0.025
	(0.028)	(0.021)	(0.022)	(0.023)
burea_cost	-0.01	-0.026**	-0.025*	-0.023*
	(0.009)	(0.012)	(0.13)	(0.013)
gdp_grw		2.855***	2.859***	3.07***
		(0.675)	(0.7)	(0.591)
infl		1.872	1.818	1.779
		(1.59)	(1.613)	(1.607)
debt		-0.188	-0.221	-0.219
		(0.189)	(0.198)	(0.2)
int_rate		-4.279***	-4.213***	-4.075**
		(1.395)	(1.413)	(1.483)
mkt_ret		-0.205***	-.0201***	-0.213***
		(0.062)	(0.063)	(0.07)
mkt_vol		-0.333	-0.31	-0.454
		(0.369)	(0.379)	(0.503)
d_crisis				0.057
				(0.069)
Number of obs	550	550	550	550
Country FE	NO	NO	YES	YES
R-squared	0.095	0.226	0.227	0.228
Chi-square / F-test	17.031	338.648	37.61	37.275
Prob > chi2 / Prob > F	0.002	0.000	0.000	0.000

Note: Robust standard error is considered to address heteroskedasticity problems.
Robust standard errors are reported in parentheses.
***, ** and * denote significance at the 1%, 5% and 10% level respectively.

5.2.2 Model 2 – Political and legal environment effects on the value of M&A deals

The results of the second model are presented in Table 7. Similar to the previous model, these regressions test several variables that proxy the political, legal and regulatory environment, along with economic control variables and fixed effect specification, of different countries at specific periods, always on the M&A activity that, in this case, has been measured as the aggregated value of the deals. As mentioned in the section above, the PCA variable is the most relevant component for this research and, in this model, the results associated show consistency with the previous regression. Specifically, with a coefficient of 0.071, the effect of a unit

increases in the PCA variable leads to a 7.1% change in the total value of M&A deals, under a statistical significance confidence level of 10%. This finding enhances and reconfirms the pivotal role played by the political and legal framework in incentivizing the M&A activity, under a second aggregation measure, supporting hypothesis 1. Consistent with the previous model are also the results related to the bureaucracy cost: the variable displays a persistent negative coefficient of -0.043 at a 10% level of statistical significance, confirming the deterrent effect that higher bureaucracy cost tends to decrease the volume associated with the M&A activity, backing hypotheses 2. As in the previous model's result, also in this setting capital controls show no statistical significance, depicting a slightly negative coefficient of -0.01, in contrast with previous results.

Notable is the role of taxation when measured on the value of the deals, which turns statistically significant at a 10% level with a coefficient of -0.032, indicating a reduction in the aggregated value of the transactions of 3.2% given an increase of one percentage point in the tax rate, in line with the results of Huizinga and Voget (2009). The reason behind the factor's significance in the second model may be related to the size sensitivity of the transactions: specifically, the tax burden becomes relevant when the financial significance of the deal is considered. The magnitude of the deals is the main determinant of tax liability and therefore, minor changes in the tax rate may influence the benefit derived from the transaction: this impact is less pronounced when the number of deals is considered since this type of aggregation, does not capture the economic scale of the M&A activity itself. Looking at the control variables included, it is worth mentioning that GDP growth maintains a considerable coefficient in line with expectations. Opposite to this latter consideration, the central bank interest rate shows a greater negative impact on the M&A when measured through deal value aggregation compared to the number of transactions: in fact, ceteris paribus, it is reasonable to expect that the larger the magnitude of the deals, the higher the percentage of debt on which companies relies on. A notable difference in the second model's result, compared to the previous one, is the high positive effect of inflation over the value of the M&A activity: specifically, the inflation variable always displays a positive coefficient that is significant at a 10% level in every regression resetting. A reason behind this may be related to investor perception that periods characterized by high inflation correspond to mispricing of the stock market, implying shares' undervaluation, as suggested by Campbell and Vuolteenaho (2004) and Modigliani and Cohn (1979), that stimulates the M&A activity.

Table 7: Model 2 - Regressions Results

	ln_value_deals	ln_value_deals	ln_value_deals	ln_value_deals
Constant	10.846***	10.903***	11.149***	11.192***
	(0.5)	(0.466)	(0.454)	(0.468)
pl_PCA	0.079**	0.072*	0.07*	0.071*
	(0.037)	(0.04)	(0.04)	(0.04)
tax	-0.037**	-0.024	-0.031*	-0.032*
	(0.018)	(0.015)	(0.016)	(0.017)
cap_contr	-0.007	-0.006	-0.009	-0.01
	(0.039)	(0.031)	(0.032)	(0.032)
burea_cost	-0.013	-0.041*	-0.039*	-0.043*
	(0.019)	(0.022)	(0.022)	(0.023)
gdp_grw		3.015*	3.128*	2.827*
		(1.57)	(1.548)	(1.686)
infl		4.601*	4.459*	4.514*
		(2.398)	(2.232)	(2.254)
debt		-0.073	-0.191	-0.195
		(0.291)	(0.325)	(0.325)
int_rate		-6.621***	-6.361***	-6.557***
		(2.011)	(2.062)	(2.064)
mkt_ret		-0.245	-0.229	-0.212
		(0.164)	(0.164)	(0.173)
mkt_vol		-0.851	-0.758	-0.553
		(0.709)	(0.716)	(0.855)
d_crisis				-0.081
				(0.133)
Number of obs	550	550	550	550
Country FE	NO	NO	YES	YES
R-squared	0.089	0.164	0.165	0.166
Chi-square / F-test	8.134	177.601	15.995	16.977
Prob > chi2 / Prob > F	0.087	0.000	0.000	0.000

Note: Robust standard error is considered to address heteroskedasticity problems.
Robust standard errors are reported in parentheses.
***, ** and * denote significance at the 1%, 5% and 10% level respectively.

6. Robustness Tests

To evaluate the robustness of the models proposed in the previous section, further tests are essential for verifying the validity and reliability of the empirical findings. Specifically, three robustness tests are carried out in this section to avoid biases arising from sample composition and independent variable specification.

6.1 US deals exclusion

As shown in Table 8, the M&A activity registered in the United States of America accounts for more than 33% of the sample, if measured as the percentage of the total number of deals,

implying a potential results' bias given by the greater weight attributed to this country. More accentuated is the effect on the country if the value of the M&A activity is considered: in this case, the attributed percentage rises to 51%, confirming the need for this robustness test.

Table 8: M&A deals per country

	num_deals (in %)	value_deals (in %)
Australia	6.48%	3.10%
Austria	0.21%	0.22%
Belgium	0.53%	0.55%
Brazil	1.81%	1.85%
Canada	6.60%	4.10%
China	12.81%	5.86%
Finland	0.61%	0.42%
France	2.72%	3.20%
Germany	2.52%	3.94%
India	1.66%	0.94%
Ireland	0.62%	0.51%
Italy	2.36%	2.35%
Japan	6.07%	2.98%
Mexico	0.59%	0.58%
Netherlands	1.15%	2.18%
Norway	0.95%	0.73%
Poland	0.95%	0.37%
Portugal	0.37%	0.22%
Russia	1.20%	1.20%
South Africa	0.85%	0.44%
Spain	2.16%	1.94%
Sweden	1.81%	1.21%
Switzerland	0.55%	1.36%
United Kingdom	11.24%	8.40%
United States	33.18%	51.37%

According to that, Model 1 and Model 2 specified in the previous sections have been tested on a new sub-sample that does not include data associated with the United States, to control the country effect further.

Table 9 reflects the results of the two models ignoring the United States transaction activity. Similar to the results displayed in Tables 6 and 7, both models show coefficient signs in line with the expectations, and robust results with the previous regression when the full sample is analysed: specifically, the PCA variable shows a positive and significant effect in relation to the number and values of the deals, reconfirm the role played by the political and judicial environment in fostering the deals activity. Always in line with the previous result, is the effect of the bureaucracy cost that is confirmed as a deterrent agent within this sub-sample analysis, showing a negative and statistically significant coefficient in both models. Lastly, control

variables such as GDP growth, inflation rate, central banks' interest rates and stock market returns confirmed the effects suggested in the previous results.

Table 9: Robustness Test 1 – US deals exclusion

	ln_num_deals	ln_value_deals
Constant	5.183***	11.032***
	(0.197)	(0.499)
pl_PCA	0.06**	0.077*
	(0.022)	(0.04)
tax	-0.008	-0.031
	(0.011)	(0.19)
cap_contr	0.026	-0.005
	(0.024)	(0.033)
burea_cost	-0.024*	-0.041*
	(0.013)	(0.023)
gdp_grw	3.095***	2.725*
	(0.574)	(1.669)
infl	1.794	4.446*
	(1.647)	(2.273)
debt	-0.22	-0.278
	(0.21)	(0.319)
int_rate	-4.201**	-6.937***
	(1.542)	(1.981)
mkt_ret	-0.21***	-0.211
	(0.071)	(0.178)
mkt_vol	-0.047	-0.447
	(0.505)	(0.873)
d_crisis	0.05	-0.092
	(0.069)	(0.135)
Number of obs	528	528
Country FE	YES	YES
R-squared	0.227	0.168
F-test	35.974	15.881
Prob > F	0.000	0.000

Note: Robust standard error is considered to address heteroskedasticity problems. Robust standard errors are reported in parentheses.
***, ** and * denote significance at the 1%, 5% and 10% level respectively.

6.2 Emerging Markets

The sample analysed in this paper covers relevant M&A activity over 22 years for 25 countries around the globe to ensure heterogeneity of the data and avoid bias that could arise from a country or region's peculiarity. Along with this, it is essential to make a macro-classification for countries that are considered developing countries and therefore have characteristics that could influence M&A activities, appearing peculiar in the eyes of companies and investors. According to the Emerging Markets Symposium, an academic initiative of Green Templeton

College (University of Oxford), a dummy variable has been created to flag countries that are considered as such resulting in a second subsample comprising 7 countries: Brazil, China, India, Mexico, Poland, Russia and South Africa. Table 10 reports the results of the two models run on Emerging Markets. As reported, the PCA variable presents a persistent statistically significant positive effect in both models, suggesting that also in Emerging Markets companies still evaluate government effectiveness and the legal environment of these countries, partially contrasting the results found by Casson and Lopes (2013). Also, the tax rate shows a significant and negative impact on the value of the M&A activity, reconfirming the key role of the fiscal burden on the transaction's magnitude.

Table 10: Robustness Test 2 – Emerging Markets

	ln_num_deals	ln_value_deals
Constant	5.256***	11.451***
	(0.592)	(0.968)
pl_PCA	0.109**	0.158*
	(0.034)	(0.079)
tax	-0.04	-0.1**
	(0.023)	(0.04)
cap_contr	0.045	0.21
	(0.078)	(0.081)
burea_cost	0.028	0.074
	(0.044)	(0.081)
gdp_grw	2.569*	5.624*
	(1.187)	(3.215)
infl	4.153	3.949
	(2.426)	(3.364)
debt	0.784	0.446
	(0.69)	(1.247)
int_rate	-4.491*	-6.037*
	(2.617)	(3.41)
mkt_ret	-0.187	-0.045
	(0.12)	(0.216)
mkt_vol	-0.218	0.068
	(1.149)	(1.513)
d_crisis	0.033	-0.052
	(0.166)	(0.3)
Number of obs	154	154
Country FE	YES	YES
R-squared	0.453	0.417
F-test	.	.
Prob > F	.	.

Note: Robust standard error is considered to address heteroskedasticity problems. Robust standard errors are reported in parentheses.
***, ** and * denote significance at the 1%, 5% and 10% level respectively.

6.3 Lagged Model

To further check the robustness of the results, a lagged model has been considered. A time lag of order one was considered on independent variables under the assumption that could not have an immediate effect on the M&A activity. Additionally, a lag of the explanatory variables allows for addressing potential endogeneity bias in the models, as De Haan (2022) and Proaño (2022) suggested. Moreover, the use of lagged variables is particularly suitable to the analysis, since M&A transactions take time to be completed. Therefore, a previous-period variable could better reflect the macroeconomic environment at the time of the deal. Table 11 shows the regressions' results of the previous models, in which all the variables have been entered with 1 lag period.

Lagging by 1 period the variables, and therefore the political, legal and macroeconomic factors, we see robust results in line with the main models: Specifically, the PCA variable still presents statistical significance and shows a positive coefficient, reconfirming how an efficient judicial environment and an effective political scenario encourage the M&A activity. The deterrent effect of the bureaucracy cost is suggested again by both models. At the same time, the negative influence of taxation can be observed only in the second model, in line with the expectation if the magnitude of the transaction is considered. Control variables' results are robust to previous findings except for the market return when tested on the value of the deals that, lagged by one period, turns significant. One reason behind it may be associated with the so-called "Hot Hand Fallacy" theory, which proposes that individuals are prone to excessive optimism in the face of a series of positive events that have occurred, leading them to think of a bull market in the subsequent period, and thus a positive performance of the shares of the companies involved in the transaction, increasing the numbers and value of M&A activity.

Table 11: Robustness Test 3 – Lagged Models

	ln_num_deals	ln_value_deals
Constant	5.331***	11.3***
	(0.194)	(0.517)
L1_pl_PCA	0.048**	0.049*
	(0.02)	(0.037)
L1_tax	-0.007	-0.032*
	(0.009)	(0.018)
L1_cap_contr	0.024	-0.017
	(0.018)	(0.034)
L1_burea_cost	-0.032***	-0.045*
	(0.012)	(0.023)
L1_gdp_grw	1.551**	0.228*
	(0.703)	(1.7)
L1_infl	-0.004	2.55
	(1.728)	(2.638)
L1_debt	-0.154	-0.208
	(0.157)	(0.285)
L1_int_rate	-4.708***	-6.474***
	(1.246)	(1.961)
L1_mkt_ret	0.149*	0.437**
	(0.084)	(0.189)
L1_mkt_vol	0.03	-0.271
	(0.353)	(0.78)
d_crisis	-0.126***	-0.187***
	(0.035)	(0.059)
Number of obs	525	525
Country FE	YES	YES
R-squared	0.20	0.18
F-test	20.464	40.732
Prob > F	0.000	0.000

Note: Robust standard error is considered to address heteroskedasticity problems. Robust standard errors are reported in parentheses.
***, ** and * denote significance at the 1%, 5% and 10% level respectively.

7. Conclusions

Recent global political events have disrupted how companies evaluate countries' legal and government systems. This study investigates the influence of country-specific political, legal and regulatory environments on the level of M&A activity. The aim of the research is to enrich the current literature, investigating the aggregate effects of variables that depict quality perception of political and legal country systems, focusing on multiple nations and capturing different periods. Specifically, the data on which the paper is based covers 25 countries around the globe spanning 22 years, from 2000 to 2021, inclusive. The measurement of the M&A activity both through the number of deals and the aggregated value allows to validate the effect

of some independent variable that impacts the M&A activity that may not be captured if only one way of measuring the latter was applied. Thus, a first model has been constructed, including only variables proxying the country's political, legal and regulatory framework and subsequently, has been controlled for economic variables which literature has identified as relevant. Lastly, a country fixed effect has been incorporated to evaluate the unobserved characteristics that are unique and intrinsic in each country, along with a dummy variable to identify the years characterized by business cycle peaks through which recession periods are identified. This right part of regression has been tested twice, on the two measures of M&A activity mentioned above. The results of both models, in line with the literature examined, highlight the importance of the variable obtained through the Principal Component Analysis, proxying government integrity and effectiveness along with judiciary independence and a clear definition of property rights laws, assessing a persistent positive and significant effect on the level of M&A activity, regardless the way it is measured supporting hypothesis 1 stating that government stability and reliability, paired with an effective and independent judiciary favour the M&A activity. In the same way, the cost of the bureaucracy depicts a constant negative and deterrent effect on the transaction activity, enhancing the cost of the deal and therefore discouraging it and confirming the validity of hypothesis 2 that a restrictive regulatory environment decreases M&A activity. Additionally, the tax burden appears to have a negative statistically significant impact only when it is measured on the value of the transaction, depressing the M&A activity in view of a higher absolute cost relative to the deal value and future revenue. Results related to economic variables always play a crucial role and specifically, GDP growth and the level of interest rates seem to be the main drivers among the control variables. The findings are in line also with the 3 robustness tests performed. Specific mention is given to the findings that political and judicial environments have significant effects also if only emerging markets are considered, in contrast with what previous literature has found. On top of that, a lagged model has been considered obtaining results in line with the main test, reinforcing the idea that the implementation process of M&A deals takes time to be completed, thus changes in macroeconomic factors may be captured through time-lags of those variables. Overall, the findings of this research emphasise a significant role played by the political, legal and regulatory environment that characterises each country in different ways, highlighting the importance of an integer and effective political and legal system paired with a not stringent regulatory framework, in attracting the interest of companies to carry out extraordinary finance operations in these countries.

8. Limitations and direction for further research

Despite the consistency and robustness of the results obtained, it must be emphasised that there are multiple limitations that need to be underlined. One of these is the data's annual frequency: in fact, a higher frequency of data, such as monthly or quarterly, may have helped in assessing the continuous change of the variables, specifically the one related to the macroeconomic activity across different countries, and would have provided a more extended and comprehensive dataset. However, this limitation arose from the fact that, for certain counties, higher data frequency was not available. A second limitation may lie in the independent variables used to evaluate the political and judicial quality level of the countries: despite the usefulness of these proxies in providing a baseline of comparison for multiple nations about characteristics that are hard to measure, they may be subject to estimation biases that are difficult to correct and therefore the correctness of these latter must be assumed. An additional limitation of the results found, despite the focus of the research, is that they only reflect the macroeconomic country's characteristics ignoring the microeconomic specification of companies undertaking the transaction. In fact, the current literature has extensively demonstrated that firm-specific characteristics such as profitability or capital intensity (Schoenberg and Reeves, 1999) are pivotal in assessing the volume and the magnitude of the M&A activity.

Additionally, a similar framework could be employed under a different methodology including VEC (Vector Error Correction) and VAR (Vector Autoregression) models, in order to understand the short-term and long-term variables' impact.

Further research may attempt to address the above-mentioned limitations, by employing higher frequency data to enlarge the dataset and capture macroeconomic change in a prompt way, using alternative proxies for political and legal environment evaluation to confirm the robustness of the results or narrowing the focus from country to industry or deal level at which would be possible to control for additional unobserved characteristics that are intrinsic to the type of the transactions, providing more granularity.

9. Appendix

Table 12: PCA Component Weights and KMO Statistic

	gov_int	gov_eff	jud_ind	prop_ri	KMO
Argentina	0.510	0.344	0.100	0.047	0.5150
Australia	0.487	0.295	0.117	0.101	0.5699
Austria	0.614	0.187	0.152	0.047	0.5868
Belgium	0.564	0.255	0.132	0.050	0.6458
Brazil	0.536	0.258	0.121	0.085	0.6728
Canada	0.494	0.322	0.117	0.067	0.5593
China	0.650	0.219	0.097	0.034	0.6229
Finland	0.499	0.221	0.164	0.116	0.6802
France	0.496	0.336	0.116	0.053	0.4413
Germany	0.539	0.250	0.180	0.031	0.5857
India	0.658	0.269	0.048	0.026	0.6106
Ireland	0.434	0.297	0.174	0.095	0.5202
Italy	0.353	0.323	0.190	0.134	0.4628
Japan	0.798	0.095	0.089	0.017	0.7274
Mexico	0.632	0.251	0.092	0.025	0.6553
Netherlands	0.449	0.326	0.156	0.069	0.4249
Norway	0.529	0.269	0.154	0.048	0.4612
Poland	0.440	0.366	0.156	0.039	0.3360
Portugal	0.544	0.245	0.164	0.048	0.4997
Russia	0.778	0.117	0.056	0.049	0.7973
South Africa	0.483	0.308	0.142	0.066	0.4723
Spain	0.437	0.302	0.186	0.075	0.4288
Sweden	0.481	0.376	0.104	0.038	0.4528
Switzerland	0.371	0.265	0.212	0.152	0.5225
United Kingdom	0.619	0.279	0.055	0.047	0.6052
United States	0.612	0.258	0.083	0.047	0.6354

Note: The table above displays the percentage proportion of each component used in the Principal Component Analysis. Components are not rotated. The weights attributed to government integrity, government efficiency, judicial independence and property rights variables are represented under column "gov int", "gov eff", "jud ind" and "prop ri", respectively. The "KMO" column indicated the value resulting from the Kaiser-Meyer-Olkin test to measure sampling adequacy.

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