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The Moderating Effect of Internal Control on Performance of Cross-Border M&A under the Uncertainty of Economic Policy: Evidence from China*

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Abstract

Purpose – The purpose of this paper is to investigate the relationship between internal control, economic policy uncertainty, and performance of cross-border merger and acquisition (M&A) based on the panel data of Chinese listed firms. The authors expected that internal control has a positive moderating effect on the performance of cross-border M&A and that it mainly occurs during periods when economic policies are relatively stable. In addition, the authors tried to find out the mechanism of internal control affecting cross-border M&A and the corporate performance.

Design/methodology – The authors tested the hypotheses by a multivariate regression model based on the panel data of Chinese listed firms from 2009 to 2017. The dependent variable is the change value of business performance (DROA_1,2,3) and the explanatory variables are cross-border M&A (MA), China's uncertainty of economic policy (EPU), and internal control level (IC) respectively.

Findings – The authors find that internal control has a positive moderating effect on the relationship between cross-border M&A and corporate performance. Further, the authors find that the moderating effect is more significant in state-owned enterprises and that it mainly occurs during periods when economic policies are relatively stable.

Originality/value – This paper is the leading study that tries to analyze empirically the relationship between internal control, economic policy uncertainty, and performance of cross-border M&A. It provides a new avenue through which internal control might reasonably mitigate the risks of cross-border M&A and correspondingly improve the performance of cross-border M&A. It also confirms the moderating effect of internal control on the performance of cross-border M&A under the uncertainty of economic policy.

Keywords: Internal Control, Moderating Effect, Performance of Cross-border M&A, Uncertainty of Economic Policy

JEL Classifications: F21, G34, G38, L25, M41

1. Introduction

Cross-border merger and acquisition (M&A) refers to the international restructuring and allocation of resources of enterprise organizations. With the rise of globalization and

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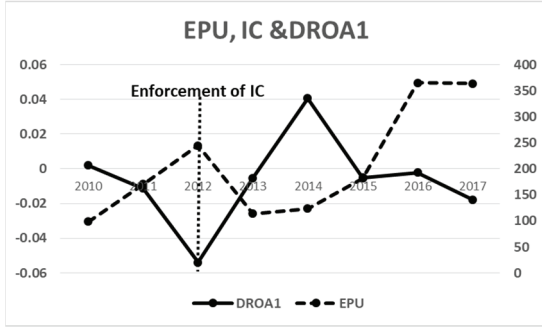
deregulation, cross-border M&As have become increasingly prevalent. The world economy recorded approximately 100,000 cross-border M&A transactions between 2005 and 2014, with a value of more than US$5 trillion (Xie, Reddy and Liang, 2017). Since the 21st century, especially since the Chinese government proposed the Belt and Road Initiative in 2013, Chinese companies' cross-border M&As have experienced unprecedented growth. However, there are uncertainties in terms of the expected performance of cross-border M&As due to many factors. Literature about the effects of cross-border M&As on firm value remains controversial. Some argue that cross-border M&As offer significant value-creation opportunities for firms (Bris and Cabolis, 2008; Fraser and Zhang, 2009; Martynova and Renneboog, 2008; Mulok and Ainuddin, 2010; Stiebale and Trax, 2011). Others believe that cross-border M&As tend to reduce the performance of M&As (Aybar and Ficici, 2009; Bertrand and Betschinger, 2012; Mangold and Lippok, 2008; Moeller, Schlingemann and Stulz, 2005).

Internal control theory (Committee of Sponsoring Organization of the Treadway Commission [COSO], 2013) holds that effective internal control helps mitigate operating risks and improve business performance. China experienced two major economic policy adjustments during the sample period. One was the adjustment of monetary and fiscal policies in 2010-2012, the other was the adjustment of trade policies in 2015-2017. Chinese companies listed on the main boards of Shanghai and Shenzhen stock exchanges have been required to implement Enterprise Internal Control Norms and Application Guidelines since 2012. The relationships between internal control[1], economic policy uncertainty, and corporate performance during the adjustment period are shown in Fig. 1 (The definitions of EPU and DROA1 are in Table 1). The figure shows that high economic policy uncertainty in 2015-2017 caused a smaller decline on corporate performance than high economic policy uncertainty in 2010-2012 owing to the enforcement of internal control in 2012. It is preliminarily concluded that the negative impact of economic policy uncertainty on corporate performance can be mitigated by internal control system.

Fig. 1. EPU, IC &DROA1



Existing literature does not examine the function mechanism and economic consequences of internal control for cross-border M&A performance in the face of economic policy uncertainty. Therefore, based on the panel data of Chinese-listed firms from 2009 to 2017, this paper focuses on the moderating effect and economic consequences of internal control on cross-border M&A performance under the uncertainty of economic policy. We find that

[1] The internal control is abbreviated as IC in Fig. 1.

corporate internal control has a positive moderating effect on the relationship between cross-border M&A and the performance. By separating the samples into state-owned-enterprise (SOE) and non-state-owned-enterprise (non-SOE) groups, we find that the moderating effect of internal control on cross-border M&A performance are more significant in SOE group. Furthermore, by separating SOE samples into two groups: those from periods with high economic policy stability and low economic policy stability, we find that the moderating effect of internal control of SOEs on cross-border M&A performance mainly occur during periods when the economic policy is relatively stable.

Our research contributes to the literature by providing new evidence for the moderating effect of internal control on the performance of cross-border M&A under the uncertainty of economic policy. A few available studies (Bonaime, Gulen and Ion, 2017; Cao, Li and Liu, 2018; Chen, Cihan and Jens, 2016) have analyzed the impact of policy uncertainty on cross-border M&A activities, and a large number of studies have researched the influencing factors of cross-border M&A. In a broad sense, the effect of corporate governance of acquirer on typical M&A and cross-border M&As are already and extensively documented in the various studies in the form of subsidiary tests (e.g., Albuquerque et al., 2018; Liu and Wang, 2013; Rani, Yadav and Jain, 2009/2013/014; Surbhi and Sandeep, 2018). However, corporate governance structure only provides direction to those executing the internal control system, which is not equal to internal control (Kurt et al., 2013). In particular, the DIB internal control index, which measures the level of internal control, is different from the corporate governance index (e.g., Li Weian, 2010; SSE Corporate Governance Index, 2008). We haven't found any directly related literature demonstrating the effects of internal control on cross-border M&A performance under economic policy uncertainty, which is the focus of this study. We provide a new avenue through which internal control might reasonably manage the risks of cross-border M&A and improve the performance under high economic policy stability.

Our research also contributes to the economic consequences of internal control and economic policy uncertainty through an empirical study of the relationships between internal control, economic policy uncertainty, and performance of cross-border M&A. A series of empirical studies provide evidence that maintaining effective internal control can provide both financial reporting and operational benefits (Ashbaugh-Skaife, Collins and Kinney, 2009; Cheng, Goh and Kim, 2018; Dhaliwal, Hogan and Trezevant, 2011; Feng, Mcvay and Skaife, 2015; Ogneva, Subramanyam and Raghunandan, 2007). A few others examine the impact of policy uncertainty on cross-border M&A (Bonaime, Gulen and Ion, 2017; Cao, Li and Liu, 2018; Chen, Cihan and Jens, 2016), but none of these empirical studies demonstrate that internal control affects the performance of cross-border M&A under the uncertainty of economic policy. In this study, based on the panel data of Chinese listed firms from 2009 to 2017, we empirically test the relationships between internal control, uncertainty of economic policy, and cross-border M&A performance and find that internal control has a positive moderating effect on the relationship between cross-border M&A and the performance. Through further analysis, we find that such moderating effect is more significant in SOEs and that it mainly occurs during periods when economic policies are relatively stable. This indicates that internal control and economic policy stability are important factors affecting the performance of cross-border M&A. Therefore, it is suggested that enterprises strengthen internal control to mitigate the risk of cross-border M&A and that the Chinese government maintain the long-term stability of the economic policy.

The remainder of the paper is organized as follows: Section 2 reviews relevant literature; Section 3 explains our hypotheses; Section 4 describes the research design; and Section 5 contains the results. We conduct several robustness checks in Section 6 and conclude the paper in Section 7.

2. Literature Review

2.1. Internal Control and Cross-Border M&A

There is burgeoning literature on the determinants of cross-border M&A, but we have not found any directly related research on the impact of internal control on cross-border M&A performance under economic policy uncertainty. Cultural difference is considered to be a salient factor affecting cross-border M&A in many studies. Cultural distance (CD) can have both negative and positive relationships with cross-border M&A value. Conn et al. (2005) employ Hofstede's (1980) cultural dimensions in their research and find that cultural differences between the acquirer and target have a negative impact on the acquirer's long-term abnormal returns. Chakrabarti et al. (2009) also use Hofstede's CD measures and find that bidder firms benefit from cross-border M&A in the long run if the bidders and target firms are from different cultural environments. Steigner and Sutton (2011) show that acquirers with high levels of intangible assets in the form of technological know-how significantly benefit from internalization in countries with great cultural differences. Ahern et al. (2015) find evidence of detrimental effects of CD on the performance of cross-border M&A. Lim Jong-Ha et al. (2016) find that the relationship between CD and cross-border M&A premiums is not uniform but varies by acquirer origin.

In addition, several studies discuss other factors affecting cross-border M&As. Bris and Cabolis (2008) find that cross-border M&As generate substantial valuation gains when the acquirer firm's country has stronger investor protection than the target firm's country, and Albuquerque et al. (2018) find that there is a positive governance spillover for nontarget firms following a cross-border M&A when the acquirer firm is from a country with higher investor protection relative to the host country. Rossi and Volpin (2004) find that firms based in weak legal environments are frequently targets of acquisition by firms located in strong legal environments. Aybar and Aysun (2009) find that the target size, ownership structure of the target, and structure of the bidder positively affect the bidder value, and the high-tech nature of the bidder and pursuit of targets in related industries negatively affect the bidder value. According to Erel et al. (2012), factors such as geography, currency movements, bilateral trade, and relative stock market valuations are associated with a greater likelihood of the occurrence of a cross-border M&A. Liou and Rao-Nicholson (2019) find that older firms are better at utilizing their experience and have better post-acquisition operating performance while facing a significant economic difference. By contrast, a younger firm benefits more after the acquisition when the home country has weaker economic freedom.

In a broad sense, the effect of corporate governance of acquirer on typical M&A and cross-border M&As are already and extensively documented in the various studies in the form of subsidiary tests, such as Albuquerque et al. (2019), Liu and Wang (2013), Surbhi and Sandeep (2018) and Rani et al. (2009/2013/2014).

2.2. Uncertainty of Economic Policy and Cross-Border M&A

A few studies have analyzed the impact of political and policy uncertainty on cross-border M&A activities, but we find no literature directly studying the impact of economic policy uncertainty on cross-border M&A performance. Bonaime, Gulen and Ion (2017) and Chen, Cihan and Jens (2016) both find that domestic political and policy uncertainty reduces acquisitions by U.S. firms. Gulen and Ion (2016) demonstrate a strong negative relationship between firm-level capital investment and the aggregate level of uncertainty associated with future policy and regulatory outcomes. Cao et al. (2018) show that political uncertainty affects both the volume and the outcome of cross-border acquisitions and that it may encourage

outbound cross-border acquisitions.

Several relevant studies have researched the economic consequences of political uncertainty, such as the impact of political uncertainty on capital structure (Desai, Foley and Hines, 2004/2008), stock price volatility (Pástor and Veronesi, 2012), bank loan (Francis, Hasan and Zhu, 2014), capital expenditures (Gulen and Ion, 2016; Jens, 2017; Julio and Yook, 2012/2016), and R&D expenditures (Atanassov, Julio and Leng, 2016). Moreover, Julio and Yook (2012) show, by using a panel of countries, that investments tend to drop significantly during election years.

A comprehensive analysis of above literature shows that a small number of studies analyze the impact of political and policy uncertainty on cross-border M&A, and a large number of studies describe the influencing factors of cross-border M&A. However, we haven't found any study directly demonstrating that internal control will affect cross-border M&A performance, especially when the economic policy is uncertain. Therefore, in this paper, we will examine the moderating effect of internal control on the relationship between cross-border M&A and corporate performance under economic policy uncertainty based on the penal of Chinese listed firms.

3. Hypothesis Development

3.1. Moderating Effect of Internal Control on the Performance of Cross-Border M&A

In general, cross-border M&As occur when the management of an acquiring firm perceives that the value of the combined firm is greater than the sum of the values of the separate firms. However, regarding value creation, a survey by KPMG reported that "only 17% of acquisitions created shareholder value while 53% destroyed it" (Shimizu, Hitt and Vaidyanath, 2004). For international deals, the failure rate ranges from 45% to 67% (Mukherji et al., 2013). According to existing literature, the following major factors may affect the costs and benefits of a merger. First, cultural difference is a salient factor affecting cross-border M&A. More literature results show that different countries often have their own cultural identities. For example, people in different countries usually have different values, customs, and religions, and sometimes they have longstanding feuds (Erel, Liao and Weisbach, 2012). Barkema, Bell and Pennings (1996) argue that foreign acquirers are more likely to fail in the cultural adjustment process than local acquirers. Second, the legal and operational costs for a cross-border M&A have something to do with the legal environment, investor protections, legal fees, politics, and policies (Albuquerque et al., 2018; Bonaime, Gulen and Ion, 2017; Bris and Cabolis, 2008; Chen, Cihan and Jens, 2009/2016; Dutta, Malhotra and Zhu, 2016; Geppert et al., 2013; Rossi and Volpin, 2004). Third, the characteristics of the target may affect the costs and benefits of the M&A, such as the target size, ownership structure, geography, and age (Bu¨lent and Ficici, 2009; Erel, Liao, and Weisbach, 2012; Liou and Rao-Nicholson, 2019). Finally, less M&A experience reduces the acquisition performance. Olivier Bertrand and Marie-Ann Betschinger (2012) show that international acquisitions tend to reduce the performance of acquirers compared to non-acquiring firms due to less M&A experience and capability of local firms.

According to the COSO (1992/2013), effective internal control can manage risks within the risk appetite and risk tolerance through a set of interrelated components, such as control environment, risk assessment, control activities, information and communication, and monitoring activities, thereby reducing risk losses and correspondingly improving business performance and value. A series of empirical studies have provided evidence that maintaining effective internal control can provide both financial reporting and operational benefits (e.g.,

Ashbaugh-Skaife et al., 2009; Cheng, Goh and Kim, 2018; Dhaliwal et al., 2011; Huang and Chen, 2017; Liao, Chen and Zheng, 2019; Ogneva, Subramanyam and Raghunandan, 2007). Ogneva, Subramanyam and Raghunandan (2007) believe that internal control deficiencies will result in lower accounting information quality, which will increase information and operational risks and result in higher capital costs. Ashbaugh-Skaife et al. (2009) find that firms with internal control deficiencies face significantly higher idiosyncratic risks, systematic risks, and costs of equity. Dhaliwal et al. (2011) test the relationship between a change in a firm's costs of debt and the disclosure of a material weakness in an initial Section 404 report and find that a firm's credit spread on its publicly traded debt marginally increases if it discloses a material weakness. Huang and Chen (2017) find that there is a positive correlation between internal control and corporate performance in the overall Chinese listed companies and various industries samples. Cheng et al. (2018) find that operational efficiency, derived from frontier analyses, is significantly lower among firms with material weakness in internal control relative to firms without such weakness. In addition, several studies have concluded that internal control defect corrections can improve business performance or value. For instance, Ashbaugh-Skaife et al. (2008) and Bedard et al. (2012) find that accruals quality improves in the year following the reported internal control problem for firms that appear to have remediated their deficiencies. Feng et al. (2015) suggest that firms that maintain ineffective internal control over financial reporting (ICFR) have weaker operating performance, both concurrently and prospectively, and that firms that remediate their ineffective ICFR experience improvements in their operating performance. Cheng et al. (2018) find that remediation of material weakness leads to an improvement in operational efficiency.

Based on the above internal control theory and empirical research results, we believe that an effective internal control system can help identify and assess the risks of cross-border M&A. Further, an effective internal control system can adopt targeted risk responses and relative control measures, such as risk sharing, reduction, and avoidance, to mitigate the losses of cross-border M&A to an acceptable extent, thus correspondingly improving the performance of cross-border M&A. Therefore, under the condition of controlling the uncertainty of economic policy and other factors, we formulate the following hypothesis:

H1: Internal control has a positive moderating effect on cross-border M&A performance.

3.2. Moderating Effect of Internal Control on Performance of Cross-Border M&A under the Uncertainty of Economic Policy

The uncertainty of economic policy means that an economic subject cannot accurately predict whether, when, and how the government will change the current economic policies (Gulen and Ion, 2016). The uncertainty of economic policy has an important impact on cross-border M&A performance because the economic policies can affect cross-border M&A and business performance. For example, if the host country of an acquirer firm adjusts its current loose monetary policy to a tight monetary policy or restricts the flow of domestic funds into overseas markets, there would be insufficient capital for the acquirer firm, thus resulting in failure of the cross-border M&A project. On the contrary, if the host country of an acquirer firm changes the current quota deduction policy to the full tax exemption policy for foreign income, the performance of the acquirer firm will be inevitably improved. In addition, the impact of economic policy uncertainty on cross-border M&A has a great degree of relevance and similarity to the impact of political and policy uncertainty on cross-border M&A. Bonaime, Gulen and Ion (2017) and Chen, Cihan and Jens (2016) both find that domestic political and policy uncertainty reduces acquisitions by U.S. firms, based on which it can be

reasonably inferred that the uncertainty of China's economic policies also affects the performance of cross-border M&As.

The uncertainty of economic policy stems from state adjustment of economic policies, which may bring about diversified, systematic, and less controllable risks. Thus, micro-economic entities such as listed firms have to accept changes in economic policies unconditionally, or disperse and circumvent the uncertainty of certain economic policies; they are unable to completely control or mitigate all economic policy uncertainties. As market players, microeconomic entities are usually able to reasonably predict and disperse or evade the uncertainty based on relatively stable economic policies. In other words, from the perspective of predictability of economic policies, during periods when economic policies are relatively stable, it is possible for microeconomic entities to correctly adjust their own cross-border M&A strategies and actions according to these economic policies with little to no adjustment for a certain period of time and achieve cross-border M&A performance. However, if the government changes the current economic policies frequently, repeatedly, or significantly, it would be difficult for firms to adjust and implement their cross-border M&A strategies and actions in a timely and correct manner and perform well in cross-border M&A.

However, from the perspective of the efficacy space of internal control, the moderating effect of internal control could be more pronounced when economic policies are relatively unstable. In detail, When the market-level uncertainty due to the economic policy changes is high, the related risk of cross-border M&A will become more significant or/and more extensive, which means that the utility space of internal control will be expanded accordingly, so a sound internal control system can effectively mitigate the significant or/and extensive risks in a greater extent through correct cross-border M&A decisions and implement. In contrast, when the level of economic uncertainty is low, the potential space for internal control to play a role is compressed, so it may not play an important role as much.

In conclusion, from the perspective of predictability of economic policies, the moderating effect of internal control on cross-border M&A performance mainly occurs during period when economic policies are relatively stable, but from the perspective of efficacy space of internal control, the opposite conclusion is drawn. Therefore, under the condition of controlling other factors, we formulate the following alternative hypothesis:

H2a: The moderating effect of internal control on cross-border M&A performance mainly occurs during period when economic policies are relatively unstable.

H2b: The moderating effect of internal control on cross-border M&A performance mainly occurs during period when economic policies are relatively stable.

4. Research Design and Sample Selection

4.1. Research Sample and Data Source

After the 2008 financial crisis, many countries strengthened their interventions in their financial markets and the real economy, thereby increasing economic policy uncertainty. In view of the impact of the financial crisis on economic policies, we take A-share listed firms in Shanghai and Shenzhen stock markets from 2009 to 2017 as the original samples and then remove the following: (1) ST companies; (2) financial and insurance companies; and (3) companies lacking research data.

The cross-border M&A data in this paper were taken from Zdatabase, a cross-border M&A database. Firms involved in these M&As are listed firms in Chinese mainland's A-share markets and were screened according to the following criteria: (1) excluding those by non-

equity investment; (2) excluding those that failed to complete M&A transactions; (3) excluding those that had been established for less than one year; (4) excluding those with a transaction size of less than RMB 1 million; and (5) excluding those with listed subsidiaries whose controlling shareholders made overseas acquisitions. For firms with missing data in Zdatabase, we manually collected and supplemented the data and then deleted samples for which data could not be supplemented.

Data on the uncertainty of policy were developed by Baker et al. (2016) and from www.policyuncertainty.com. The internal control data were drawn from DIB Internal Control and Risk Management Database. Listed firms' financial data and shareholding structure data were all extracted from the Shenzhen GTA Database (CSMAR).

4.2. Model Setting and Variable Description

In this paper, under the condition of controlling the main factors affecting performance, a multivariate regression model (1) is established to test the research hypothesis.

$$\begin{aligned} \mathrm{DROA}_{1,2,3} = {} & \alpha_0 + \alpha_1 \mathrm{MA} + \alpha_2 \mathrm{EPU} + \alpha_3 \mathrm{IC} + \alpha_4 \mathrm{L1IC} + \alpha_5 \mathrm{IC} \times \mathrm{MA} + \\ & \alpha_6 \mathrm{L1IC} \times \mathrm{MA} + \sum \alpha_i \mathrm{Controls}_i + \sum \alpha_j \mathrm{Industry}_j + \sum \alpha_k \mathrm{Year}_k + \varepsilon \end{aligned} \quad (1)$$

The dependent variable is the change value of business performance ($\mathrm{DROA}_{1,2,3}$). Xia (2017) finds that, among the indicators for measuring performance, profitability has the highest utilization rate, and the indicators include the return on total assets (ROA), return on equity (ROE), profit margin of main business (ROS), Tobin Q value, and earnings per share (EPS). This paper uses ROA to measure business performance. The ROA is industry-adjusted by subtracting the mean ROA in their industry based on industry classification issued by China Securities Regulatory Commission in 2016. Following Cai and Sevilir (2012) method, for firms having cross-border M&A in the current year, this paper calculates $\mathrm{DROA}_{1,2,3}$ by adopting the ROA of the first year, the second year, and the third year after the completion of M&A respectively, minus the ROA of the previous year. For firms without cross-border M&A in the current year, a similar method is adopted to calculate $\mathrm{DROA}_{1,2,3}$. As data about the ROA go up to 2018, we removed the 2017 data when testing DROA2 and removed the 2016 and 2017 data when testing DROA3.

Main explanatory variable 1, cross-border M&A (MA), is a dummy variable. According to the cross-border M&A data of Zdatabase, if the company conducted a cross-border M&A in the current year, it takes 1; otherwise, it takes 0.

Main explanatory variable 2, China's uncertainty of economic policy (EPU), which is a continuous variable and measured by EPU index (www.policyuncertainty.com). The method of measuring economic policy uncertainty is presented by Baker et al. (2016), which has been widely recognized as a reliable measure of the overall level of policy uncertainty in the economy (Gulen and Ion, 2016; Zhang et al., 2019). For China, the EPU index is constructed from a scaled frequency count of policy-related articles published in the South China Morning Post (the leading English-language newspaper in Hong Kong).

Main explanatory variable 3, internal control level (IC), is a classified variable. Following Quan et al. (2015), Ye et al. (2015) and Zhou et al. (2016), we use DIB Internal Control Index of Listed Firms in China to measure the internal control level of samples and carry out the quintile grouping, i.e. the internal control level of each group is taken 1, 2, 3, 4 and 5 respectively from bottom quintile to top quintile. DIB Internal Control Index is a composite index reflecting the level of internal control of all listed firms in China, which has been widely recognized by Chinese government regulators, academia and listed companies. It takes the

realization degree of the five objectives of internal control (compliance objectives, reporting objectives, asset safety objectives, operations objectives and strategic objectives) as the basic index of internal control, and takes the deficiency of internal control as the correction variable to modify the basic index of internal control, and finally forms the composite index that comprehensively reflects the internal control level of a listed firm. The index adopts the thousandth system and the value range is [0, 1000].

The control variables are operating income growth rate (Lgrowth), asset-liability ratio (Llev), equity concentration (Lshare), asset size (Lsize), cash flow ratio (LOCF), company listing age (Age), property rights (State), auditor (Big4), industry, and year. Among these, Lgrowth, Llev, Lshare, Lsize, and LOCF, which are variables involving financial data, are data of the previous year. In addition, with regard to the influencing factors, such as cultural differences, industry differences, and M&A experience mentioned in the literature, we find that the impact on Chinese companies' cross-border M&A performance is not significant. Therefore, the model in this paper does not include these factors. The variables are defined in Table 1.

Table 1. Variable Definitions

Variables	Variable symbol	Variable definition
Change in return on assets	$DROA_{1,2,3}$	$DROA_1=ROA_{t+1}- ROA_{t-1}$ $DROA_2=ROA_{t+2}- ROA_{t-1}$ $DROA_3=ROA_{t+3}- ROA_{t-1}$
Cross-border M&A	*MA*	If the company conducts a cross-border M&A in the current year, it takes 1; otherwise, it takes 0.
Uncertainty of economic policy	*EPU*	The average value of the monthly uncertainty indicator of Chinese economic policy and the annual value, which are measured by EPU index (www.policyuncertainty.com)
Internal control level	*IC,L1IC*	Measured by DIB internal control index and grouped the samples in quintiles. The internal control level of each group is taken 1, 2, 3, 4 and 5 respectively from bottom quintile to top quintile. L1IC is the level of internal control of the previous year.
Business revenue growth rate	*Growth*	The difference between the current period and the previous period's operating income is divided by the previous period's operating income.
Asset-liability ratio	*Lev*	Total liabilities divided by total assets.
Equity concentration	*Share*	The proportion of the controlling shareholder directly holding shares in the listed company.
Asset size	*Size*	The natural logarithm of total assets at the end of the year.
Cash flow ratio	*OCF*	The ratio of net cash flow from operating activities to total assets.
Listing age	*Age*	The number of years since the company was listed.
Property right state	*State*	If the actual controller disclosed by the enterprise is a state-owned entity, the value will be 1; otherwise, it is 0.
Auditor	*Big4*	If the accounting firm hired is one of the four major international accounting firms, the value will be 1; otherwise, it is 0.
Industry	*Industry*	Industry fixed effect
Year	*Year*	Annual fixed effect

5. Empirical Test Result and Analysis

5.1. Descriptive Statistical Analysis

Table 2 reports the descriptive statistics of the main variables. It can be seen that, after the financial crisis, the performance of Chinese enterprises witnessed a downward trend as a whole. Among them, those that made cross-border M&As saw more negative effects on their performance in the 1-2 years following their M&As, especially in the second year after M&As, compared with those that had no M&A activity. The companies that had cross-border M&As have a higher average value than those that did not have a merger in terms of internal control, but it is not significant. The comparison also shows that companies with M&A activities were larger, younger, and they prefer to hire Big 4 firms to audit their financial statements.

Table 2. Descriptive Statistics of Variables

Variable	N	Mean	Median	S.D.	Min	Max	MA1-MA0
			MA=1				MeanDiff
DROA1	330	-0.010	-0.005	0.057	-0.242	0.185	-0.004
DROA2	253	-0.013	-0.003	0.056	-0.266	0.185	-0.007 **
DROA3	162	-0.010	-0.005	0.068	-0.258	0.176	-0.002
IC	326	0.104	-0.056	1.471	-2.056	1.944	0.107
L1IC	263	0.233	-0.056	1.478	-2.056	1.944	0.129
Lgrowth	330	0.367	-0.040	4.279	-25.240	38.580	-0.148
Llev	330	0.419	0.426	0.198	0.050	0.868	-0.004
Lshare	330	0.376	0.356	0.158	0.091	0.759	-0.007
Lsize	330	22.580	22.260	1.450	19.690	26.020	0.519 ***
LOCF	330	0.057	0.052	0.067	-0.251	0.431	0.001
Age	330	9.271	6.852	6.197	2.022	27.050	-1.466 ***
Big4	330	0.176	0.000	0.381	0.000	1.000	0.111 ***
			MA=0				MedianDiff
DROA1	11239	-0.005	-0.002	0.050	-0.401	0.351	-0.003 **
DROA2	8580	-0.006	-0.002	0.050	-0.401	0.351	-0.001
DROA3	6338	-0.008	-0.004	0.054	-0.388	0.291	-0.001
IC	11037	-0.003	-0.056	1.407	-2.056	1.944	0.000
L1IC	8421	0.104	-0.056	1.406	-2.056	1.944	0.000
Lgrowth	11239	0.515	-0.094	5.269	-25.240	38.580	0.054
Llev	11239	0.423	0.416	0.203	0.05	0.868	0.010
Lshare	11239	0.383	0.371	0.151	0.091	0.759	-0.015
Lsize	11239	22.070	21.890	1.247	19.690	26.020	0.370 ***
LOCF	11239	0.056	0.054	0.076	-0.565	0.727	-0.002
Age	11239	10.740	9.942	6.212	2.003	27.080	-3.090 ***
Big4	11239	0.065	0	0.246	0	1	0.000 ***

Note: The continuous variables are winsorized at 1% and 99% levels, and the IC and L1IC are centered.

5.2. Regression Analysis

5.2.1. Internal Control, Cross-Border M&A and Corporate Performance

Table 2 shows the regression results of the relationships between internal control, cross-border M&A, and corporate performance. The coefficient of MA indicates that cross-border M&A is negatively correlated with corporate performance. The *p*-values of the coefficients of MA are 0.104 and 0.075 in Columns 1 and 3. After adding interaction items IC*MA and L1IC*MA, the p-values are 0.086 and 0.101 in Columns 2 and 4, which are significant or approximately significant. MA is negatively correlated with DROA3, but the correlation is not significant. This shows that cross-border M&As of Chinese enterprises failed to increase corporate values in the short term but led to a significant decline in the performance of acquirer firms in the first and second years after the merger. This finding is basically similar to the research conclusions of Ayba and Ficici (2009) and Bertrand and Betschinger (2012).

Table 3. Internal Control, M&A and Firm Performance

	DROA1	**DROA1**	**DROA2**	**DROA2**	**DROA3**	**DROA3**
	(1)	**(2)**	**(3)**	**(4)**	**(5)**	**(6)**
MA	-0.005	-0.006 *	-0.007 *	-0.007	-0.004	-0.005
	(0.104)	(0.086)	(0.075)	(0.101)	(0.404)	(0.353)
EPU	-0.000 ***	-0.000 ***	-0.000 ***	-0.000 ***	0.000 ***	0.000 ***
	(0.000)	(0.000)	(0.001)	(0.001)	(0.000)	(0.000)
IC	0.004 ***	0.004 ***	-0.002 ***	-0.002 ***	-0.000	-0.000
	(0.000)	(0.000)	(0.000)	(0.000)	(0.626)	(0.509)
L1C	-0.003 ***	-0.004 ***	-0.002 ***	-0.002 ***	-0.004 ***	-0.004 ***
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
IC*MA		0.001		0.004 *		0.003
		(0.660)		(0.093)		(0.297)
L1IC*MA		0.002		-0.001		0.001
		(0.247)		(0.812)		(0.756)
Lgrowth	-0.000 ***	-0.000 ***	-0.000 ***	-0.000 ***	-0.001 ***	-0.001 ***
	(0.001)	(0.001)	(0.009)	(0.010)	(0.000)	(0.000)
Llev	0.021 ***	0.021 ***	0.009 **	0.009 **	0.024 ***	0.024 ***
	(0.000)	(0.000)	(0.019)	(0.018)	(0.000)	(0.000)
Lshare	0.010 ***	0.010 ***	0.013 ***	0.013 ***	0.014 ***	0.014 ***
	(0.002)	(0.002)	(0.000)	(0.000)	(0.003)	(0.003)
Lsize	-0.003 ***	-0.003 ***	0.001	0.001	0.001	0.001
	(0.000)	(0.000)	(0.374)	(0.381)	(0.105)	(0.101)
LOCF	-0.000	-0.000	-0.018 **	-0.018 **	-0.022 **	-0.022 **
	(0.974)	(0.977)	(0.047)	(0.046)	(0.043)	(0.046)
Age	0.000 ***	0.000 ***	0.000 ***	0.000 ***	0.000 ***	0.000 ***
	(0.000)	(0.000)	(0.002)	(0.002)	(0.009)	(0.010)
State	0.003 ***	0.003 ***	0.004 ***	0.004 ***	0.003 *	0.003 *
	(0.004)	(0.005)	(0.003)	(0.003)	(0.074)	(0.076)
Big4	0.002	0.002	0.001	0.001	-0.002	-0.002
	(0.225)	(0.247)	(0.490)	(0.515)	(0.399)	(0.365)
Intercept	0.047 ***	0.047 ***	-0.035 **	-0.034 **	-0.127 ***	-0.128 ***
	(0.000)	(0.000)	(0.028)	(0.029)	(0.000)	(0.000)
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
N	8621	8621	6623	6623	4875	4875
Adj. R^2	0.256	0.256	0.251	0.251	0.292	0.292

Note: *p<0.1, **p<0.05, ***p<0.01.

The coefficient of the interaction item IC*MA is significantly positive in the DROA2 regression equation, indicating that internal control has a positive moderating effect on cross-border M&A performance in the second year. However, the coefficient of IC*MA is not significant in DROA1 and DROA3, and the coefficient of LIC*MA is not significant in all three models.

Different from Western countries, such as the United States and Britain, China's SOEs are the backbone of national economic development. The state is the capital owner or controller of SOEs. The will and interests of the government determine the behaviors of SOEs. Chinese SOEs boast a natural advantage in accessing national policy support and financial resources (Lu, Zhu and Zhang, 2012). Therefore, this paper divides the samples into SOEs and non-SOEs for subdivision testing. The regression results are shown in Table 4. In the SOE group, the coefficient of interaction item ICI*MA is significant in DROA1 and DROA2, and the *p*-value of DROA3 is 0.108, which is very close to the significance level. It can be seen that internal control of SOEs has a significant positive moderating effect on their cross-border M&A performance, which verifies hypothesis H1.

Table 4. Internal Control, M&A and Firm Performance of SOEs and non-SOEs

	State=1 DROA1 (1)	**State=0 DROA1 (2)**	**State=1 DROA2 (3)**	**State=0 DROA2 (4)**	**State=1 DROA3 (5)**	**State=0 DROA3 (6)**
MA	0.005	-0.006 *	-0.007	-0.006	-0.010	-0.004
	(0.468)	(0.084)	(0.160)	(0.264)	(0.367)	(0.555)
EPU	-0.000 ***	-0.000 ***	0.000 *	-0.000 ***	0.000 ***	0.000 ***
	(0.005)	(0.000)	(0.057)	(0.001)	(0.000)	(0.000)
IC	0.002 ***	0.005 ***	-0.002 ***	-0.002 ***	-0.000	-0.001
	(0.000)	(0.000)	(0.000)	(0.001)	(0.547)	(0.423)
L1IC	-0.003 ***	-0.004 ***	-0.001 ***	-0.002 ***	-0.004 ***	-0.004 ***
	(0.000)	(0.000)	(0.006)	(0.002)	(0.000)	(0.000)
IC*MA	0.004 *	-0.001	0.009 **	0.002	0.005	0.002
	(0.072)	(0.705)	(0.045)	(0.506)	(0.108)	(0.566)
L1IC*MA	-0.006 *	0.004	-0.007	0.002	0.004	-0.000
	(0.078)	(0.144)	(0.129)	(0.639)	(0.557)	(0.982)
Lgrowth	-0.000 **	-0.001 ***	-0.000	-0.001 **	-0.000 ***	-0.001 **
	(0.036)	(0.005)	(0.224)	(0.026)	(0.005)	(0.022)
Llev	0.021 ***	0.022 ***	0.008 *	0.011 *	0.022 ***	0.029 ***
	(0.000)	(0.000)	(0.090)	(0.075)	(0.000)	(0.000)
Lshare	0.005	0.012 **	0.009 *	0.016 ***	0.015 **	0.014 *
	(0.254)	(0.013)	(0.078)	(0.004)	(0.022)	(0.061)
Lsize	-0.001	-0.004 ***	0.002 **	-0.001	0.002 **	-0.001
	(0.362)	(0.000)	(0.039)	(0.490)	(0.038)	(0.641)
LOCF	-0.027 ***	0.015	-0.029 ***	-0.011	-0.060 ***	0.010
	(0.009)	(0.197)	(0.009)	(0.417)	(0.000)	(0.555)
Age	0.000	0.001 ***	-0.000	0.001 ***	0.000	0.001 ***
	(0.233)	(0.000)	(0.904)	(0.001)	(0.506)	(0.007)
Big4	0.001	0.001	0.001	0.001	-0.002	-0.003
	(0.387)	(0.793)	(0.724)	(0.818)	(0.335)	(0.746)
Intercept	0.006	0.082 ***	-0.044 ***	-0.011	-0.128 ***	-0.104 ***
	(0.738)	(0.000)	(0.009)	(0.682)	(0.000)	(0.004)
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
N	3910	4711	3102	3521	2342	2533
Adj. R^2	0.301	0.257	0.328	0.236	0.336	0.290

Note: *p<0.1, **p<0.05, ***p<0.01.

5.2.2. Uncertainty of Economic Policy, Internal Control and M&A Performance

We take the economic policy uncertainty value 300 as the standard to classify SOE samples into two groups, during periods of high economic policy uncertainty and low economic policy uncertainty, for regression analysis. The regression results in Table 5 show that the coefficient of interaction item IC*MA is significantly negative when the EPU is less than 300 but not significantly negative when the EPU is more than 300, indicating that the impact of internal control on corporate cross-border M&A performance mainly occurred in years during which the economic policy uncertainty value was lower, i.e., periods when economic policies were relatively stable, which rejects hypothesis H2a and verifies hypothesis H2b.

Table 5. EPU, Internal Control and M&A Performance

	EPU>300 DROA1 (1)	**EPU<300 DROA1 (2)**	**EPU>300 DROA2 (3)**	**EPU<300 DROA2 (4)**
MA	0.005	0.005	-0.015	-0.008 **
	(0.547)	(0.604)	(0.591)	(0.020)
IC	0.003 ***	0.002 ***	-0.002	-0.002 ***
	(0.009)	(0.001)	(0.155)	(0.001)
L1IC	-0.004 ***	-0.003 ***	-0.002	-0.001 **
	(0.000)	(0.000)	(0.186)	(0.014)
IC*MA	-0.003	0.006 ***	0.014	0.006 ***
	(0.494)	(0.008)	(0.474)	(0.000)
L1CI*MA	-0.007	-0.005	-0.018	-0.001
	(0.135)	(0.336)	(0.165)	(0.725)
Lgrowth	-0.000	-0.000 *	-0.000	-0.000
	(0.114)	(0.082)	(0.471)	(0.351)
Llev	0.016 *	0.022 ***	-0.005	0.009 *
	(0.080)	(0.000)	(0.684)	(0.064)
Lshare	0.013	0.002	0.029 *	0.004
	(0.186)	(0.645)	(0.091)	(0.373)
Lsize	0.001	-0.001	0.002	0.001 *
	(0.576)	(0.112)	(0.284)	(0.070)
LOCF	0.015	-0.038 ***	0.044	-0.039 ***
	(0.463)	(0.002)	(0.115)	(0.001)
Age	0.000	0.000	-0.000	0.000
	(0.895)	(0.113)	(0.941)	(0.994)
Big4	-0.002	0.002	-0.000	0.001
	(0.565)	(0.234)	(0.972)	(0.723)
Intercept	-0.040	0.018	-0.055	-0.038 **
	(0.246)	(0.327)	(0.187)	(0.038)
Industry FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
N	1017	2893	485	2617
Adj. R^2	0.067	0.379	0.103	0.382

Note: *p<0.1, **p<0.05, ***p<0.01.

6. Robustness Tests

Table 2 shows that the scale of cross-border M&A companies is large, which may cause endogenous problems in sample selection to some extent. Therefore, this paper uses propensity score matching (PSM), which was originally defined by Rosenbaum and Rubin (1983), to control endogenous problems. In applying the PSM method, the Logit model and K-nearest neighbor matching are used. According to Wang and Kan (2014), and considering the significance of the variables, the operating income growth rate, the asset-liability ratio, equity concentration, asset size, and the nature of property rights are determined as covariates and the industry is controlled. The Logit model used to calculate the propensity score in the first stage of PSM is shown in equation (2).

$$Logit(MA) = \alpha_0 + \alpha_1 \text{Lgrowth} + \alpha_2 \text{Llev} + \alpha_3 \text{Lshare} + \alpha_4 \text{Lsize} + \alpha_5 \text{State} + \sum \alpha_i \text{Industry}_i + \varepsilon \quad (2)$$

Based on the Logit model (2), we perform one-to-one matching and obtain a total of 660 samples, then make regression analysis of the matched samples. Table 6 and Table 7 are the regression results obtained after PSM matching. In Table 6, the coefficient of interaction item IC*MA is significant in models other than the DROA1 regression model for the state=0 samples, and the regression results of the matched samples better support the positive effect of internal control on M&A performance compared with all samples. In order to test the impact of economic policy uncertainty, we use 200 and 300, respectively, as the criteria for distinguishing high and low uncertainties of economic policy. The regression results show that the impact of internal control on cross-border M&A performance mainly occurred during periods when economic policies were relatively stable. Due to space limitations of the paper, Table 7 only reports regression results based on the standard of 200.

Table 6. Internal Control, M&A and Firm Performance of SOEs and non-SOEs

	State=1 DROA1 (1)	State=0 DROA1 (2)	State=1 DROA2 (3)	State=0 DROA2 (4)	State=1 DROA3 (5)	State=0 DROA3 (6)
MA	0.010	0.020	-0.008	-0.084 **	0.002	-0.036
	(0.222)	(0.344)	(0.287)	(0.011)	(0.902)	(0.515)
EPU	-0.000	-0.000	0.000	-0.000	0.000 ***	0.001 *
	(0.178)	(0.350)	(0.705)	(0.556)	(0.001)	(0.065)
IC	0.002	0.003	-0.002	-0.036 ***	0.000	-0.043 **
	(0.452)	(0.806)	(0.282)	(0.007)	(0.970)	(0.018)
L1CI	-0.002	-0.022	-0.002	0.004	-0.002	-0.065 ***
	(0.476)	(0.214)	(0.437)	(0.668)	(0.531)	(0.002)
IC*MA	0.007 *	0.001	0.010 *	0.036 ***	0.009 *	0.044 **
	(0.067)	(0.934)	(0.077)	(0.006)	(0.089)	(0.017)
L1CI*MA	-0.006	0.022	-0.007	-0.007	0.003	0.066 ***
	(0.143)	(0.220)	(0.138)	(0.520)	(0.711)	(0.002)
Lgrowth	-0.001 *	0.001	-0.000	-0.001	-0.001	-0.002
	(0.061)	(0.541)	(0.866)	(0.491)	(0.173)	(0.460)
Llev	0.014	0.015	0.030 **	-0.023	0.028	-0.031
	(0.409)	(0.617)	(0.041)	(0.545)	(0.192)	(0.517)
Lshare	0.002	0.008	0.015	0.007	0.003	-0.055
	(0.881)	(0.771)	(0.277)	(0.852)	(0.889)	(0.152)

Table 6. (Continued)

	State=1 DROA1 (1)	State=0 DROA1 (2)	State=1 DROA2 (3)	State=0 DROA2 (4)	State=1 DROA3 (5)	State=0 DROA3 (6)
Lsize	-0.003	-0.006	-0.004	0.011	-0.004	-0.005
	(0.327)	(0.207)	(0.236)	(0.135)	(0.361)	(0.662)
LOCF	-0.047 *	0.037	0.035	0.054	-0.056 **	-0.018
	(0.095)	(0.635)	(0.340)	(0.638)	(0.042)	(0.883)
Age	0.001 **	0.000	-0.001 **	-0.000	0.000	0.003 *
	(0.038)	(0.593)	(0.041)	(0.974)	(0.856)	(0.054)
Big4	-0.007	0.016	0.019 **	0.011	-0.014	0.020
	(0.174)	(0.417)	(0.018)	(0.549)	(0.101)	(0.598)
Intercept	0.065	0.096	0.045	-0.207	-0.014	-0.057
	(0.368)	(0.353)	(0.535)	(0.147)	(0.880)	(0.788)
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
N	277	218	224	162	175	110
Adj. R^2	0.396	0.197	0.354	0.158	0.351	0.271

Note: *p<0.1, **p<0.05, ***p<0.01.

Table 7. EPU, Internal Control and M&A Performance

	EPU>200 DROA1	EPU<200 DROA1	EPU>200 DROA2	EPU<200 DROA2	EPU>200 DROA3	EPU<200 DROA3
MA	-0.003	0.021 **	-0.030	0.004	-0.048	-0.004
	(0.806)	(0.047)	(0.340)	(0.614)	(0.267)	(0.833)
IC	-0.001	0.003	-0.001	-0.003	-0.009	0.001
	(0.844)	(0.194)	(0.881)	(0.315)	(0.333)	(0.767)
L1IC	-0.002	-0.002	-0.010 **	0.001	-0.005	-0.002
	(0.584)	(0.489)	(0.041)	(0.567)	(0.573)	(0.588)
IC*MA	0.008	0.007 *	0.013	0.011 ***	0.026	0.005
	(0.370)	(0.073)	(0.561)	(0.004)	(0.448)	(0.377)
L1CI*MA	-0.008	-0.004	-0.008	-0.008 *	0.010	0.000
	(0.220)	(0.473)	(0.553)	(0.063)	(0.792)	(0.962)
Lgrowth	-0.004 ***	-0.000	-0.000	0.000	-0.007	-0.000
	(0.000)	(0.526)	(0.876)	(0.416)	(0.241)	(0.250)
Llev	0.060 ***	-0.013	0.036	0.030 *	0.028	0.022
	(0.008)	(0.543)	(0.417)	(0.080)	(0.696)	(0.345)
Lshare	0.047 **	-0.020	0.053	0.004	0.102	-0.024
	(0.039)	(0.209)	(0.226)	(0.805)	(0.166)	(0.296)
Lsize	0.002	-0.006 *	-0.003	-0.007 *	-0.004	0.002
	(0.760)	(0.087)	(0.700)	(0.055)	(0.796)	(0.768)
LOCF	-0.088 **	-0.024	0.065	0.019	-0.051	-0.058 *
	(0.034)	(0.460)	(0.305)	(0.629)	(0.441)	(0.064)
Age	-0.000	0.001 *	-0.002	-0.001	-0.001	-0.000
	(0.747)	(0.091)	(0.104)	(0.120)	(0.628)	(0.849)
Big4	-0.013	-0.012 *	0.045 *	0.009	-0.011	-0.016
	(0.192)	(0.062)	(0.077)	(0.138)	(0.752)	(0.109)
Intercept	-0.138	0.144 *	-0.025	0.121	0.047	-0.076
	(0.243)	(0.051)	(0.856)	(0.101)	(0.874)	(0.494)
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
N	102	175	64	160	30	145
Adj. R^2	0.567	0.281	0.183	0.426	0.204	0.340

Note: *p<0.1, **p<0.05, ***p<0.01.

7. Conclusion

Based on the panel of Chinese listed firms from 2009 to 2017, this paper studies the mechanism and moderating effect of internal control for cross-border M&A performance under the uncertainty of economic policy. The empirical results in this paper show that internal control has a positive moderating effect on the relationship between cross-border M&A and corporate performance. Further research finds that the moderating effect of internal control on cross-border M&A performance are more significant in SOEs and mainly occur during periods when economic policies are relatively stable. In addition, this paper also finds that cross-border M&As cannot increase the value of enterprises in the short term but lead to a decline in the performance of acquirer firms in the first two years after M&As.

This research has theoretical and managerial implications, which contribute to the emerging literature attempting to understand the role of internal control in cross-border M&A practices under the uncertainty of economic policy. The mechanism of internal control on the performance of cross-border M&A is that an effective internal control can manage the risks of cross-border M&A within the risk appetite and risk tolerance through a set of interrelated components, such as control environment, risk assessment, control activities, information and communication, and monitoring activities, thereby mitigating the losses of cross-border M&A to an acceptable extent, thus correspondingly improving the performance of cross-border M&A.

Our findings also have practical and policy implications. This paper documents comprehensive empirical evidence showing that internal control in China may be an effective mechanism to mitigate the risks and corresponding losses of cross-border M&A during periods when the economic policy is relatively stable. Therefore, it is recommended that acquirer firms (whether state-owned or non-state-owned) improve the performance of cross-border M&A by strengthening internal control and that the Chinese government makes efforts to maintain the long-term stability of the economic opening-up policy.

We only take the economic policy uncertainty of the acquirer country as the explanatory variable. In future research, the economic policy uncertainty of the target country need to be examined. In addition, the accuracy of DIB internal control index to measure the effectiveness of internal control needs more tests in practice.

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