World Journal of Economics and Business Research
Print ISSN: 2960-0073
Online ISSN: 2960-0081
DOI: https://doi.org/10.61784/wjebr3072

BILATERAL DIPLOMATIC RELATIONS AND CROSS-BORDER M&AS: EVIDENCE FROM CHINA

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Abstract: Cross-border mergers and acquisitions (M&A) are one of the most important ways for countries to participate in the global economy. China's bilateral diplomatic relations with other countries are flawed and the data are mainly from the Chinese media, which may lead to omissions in diplomatic events, lack of objectivity and insufficient information, which may lead to miscalculations. Therefore, it is necessary to select a measure that reflects the high level of recognition between the two countries in international affairs or bilateral affairs. Using unbalanced panel data (including cross-border M&A data and United Nations General Assembly (UNGA) voting data) for 181 countries (or regions) from 1992-2017, the paper empirically examines the impact of bilateral diplomatic relations on China's cross-border M&A completion rate and its mechanism of action, by building an estimation model, mediation effect models, and conducting a robustness test. The mediating effect in the mechanism test finds that bilateral diplomatic relations affect the completion rate of cross-border M&As between Chinese and foreign firms through both formal (i.e., the signing of BITs and the establishment of bilateral partnerships) and informal mechanisms (i.e., exchanges among senior bilateral leaders and the establishment of Confucius Institutes). For formal institutions, bilateral diplomatic relations can increase the completion rate of cross-border M&As from and to China by facilitating the signing of BITs and the establishment of bilateral partnerships. For informal institutions, bilateral diplomatic relations increase the completion rate of cross-border M&As from and to China by facilitating exchanges between high-level leaders of the two countries and the establishment of Confucius Institutes. The results of the study show that bilateral diplomatic relations can help improve formal and informal systems to facilitate successful cross-border M&As, and the Chinese Government can draw on the successful experience of political diplomacy to create more opportunities for bilateral political, economic and cultural exchanges. In addition, both China and other countries can actively explore bilateral and multilateral cooperation mechanisms and promote the establishment or formulation of new cooperation rules and agreements.
Keywords: China; Cross-border mergers and acquisitions; Bilateral diplomatic relations; Mediating effect

1 INTRODUCTION

As the largest source of outward foreign direct investments (OFDI) from emerging economies, China has emerged as a leading global investor by proactively pursuing cross-border mergers and acquisitions (M&As). According to Thomson SDC statistics, the total amount of Chinese firms' cross-border M&As has increased from US $ 1.38 billion in 2002 to US $ 135.33 billion in 2016, increased by 98 times. But the failure rate of Chinese firms' cross-border M&As is also very high.

Existing literature indicates that the failure rate of cross-border M&As is very high, as firms confront "distance" such as institutional and cultural distance and the Liability of Foreignness [1]. Drawing on the institutional perspective, some studies consider the home-country institutional context and identify that government support also contribute to Chinese OFDI. Bilateral diplomatic relations establish a "bridge" between the host and the home country institution, creating a favorable political mutual trust and institutional ties for foreign firms to enter each others' market[2-4]. Apparently, government involvement gives cross-border firms a unique path in terms of international expansionThese limited studies highlight that bilateral diplomatic relations have become an important engine in promoting Chinese OFDI [5,6]. However, we are still unclear as to whether friendly bilateral diplomatic relations play a positive role in cross-border M&As and what is the mechanism.

In the existing researches, bilateral diplomatic relations between China and other countries are mainly measured by high-level leaders' mutual visits [7], bilateral partnership [8] and diplomatic relations between major powers [9]. However,these measures may be flawed. First, the number of high-level leaders' bilateral visits or diplomatic relation in major powers is limited, the duration is short. The concept of bilateral partnership is ambiguous and unclear [10] Second, the data is mainly obtained from Chinese media, which may cause the problem of omissions of diplomatic events. There may be lack of objectivity and insufficient information, which leads to misjudgment [11]. Therefore, it is necessary to choose a measure that is general, including most countries, and can reflect the high degree of recognition of the two countries in international affairs or bilateral affairs in order to better reflect the results of friendly diplomatic relations between the two countries.

At present, in the international political field, the United Nations voting data is used to reflect the foreign policy preferences of a country [12], and the foreign policy similarity between two countries can represent bilateral diplomatic relations between two countries[4,13]. China uses diplomacy tools to increase foreign policy similarity with other countries through the following channels. First, China use economic diplomacy to strengthen economic ties with many countries in the world, which can be further transformed into foreign policy similarity[2]. Second, outside the economic realm, soft power strategy is a comprehensive diplomatic tool which can facilitate bilateral relationship and recognition[14]. Third, China win other countries' support has been facilitated by a general shift from a "responsive" to a "proactive diplomacy," state and public diplomacy [15], expanding international influence and "generate bargaining leverage in its bilateral interactions" [16]. Strong political ties potentially further increase foreign policy similarity[17]. Thus, bilateral diplomatic relationship between China and other countries has close relationship with foreign policy similarity,foreign policy similarity is also a comprehensive representative of bilateral relationship.

Against this background, this study aims to investigate the impact of bilateral diplomatic relations on the completion of cross-border M&As from and to China and further examine the effect mechanism. The main contribution of the paper lies in the following ways. First, this paper focuses on the impact of bilateral diplomatic relations on the success rate of cross-border M&As from and to China. Existing literature has examined the impact of bilateral diplomatic relations on the total amount of trade or investment, instead of the success rate of investment. Diplomatic relations play important role in reducing investment risk for cross-border M&As,thus,it is necessary to see whether diplomatic relation have positive effect in reducing cross-border investment risk. However, endogenous problem may exist,that is whether cross-border M&As affect bilateral diplomatic relation, so we use GMM and IV method to solve this problem in the robustness test. Moreover, compared to the existing studies which mainly focus on the success rate of Chinese firms' cross-border M&As, we discuss the effect of bilateral diplomatic relations on the success rate of cross-border M&As both from and to China. Second, we further discuss the mechanism of the impact of bilateral diplomatic relations on the success rate of cross-border M&As, mainly from formal institution such as the signing of bilateral investment agreements and the establishment of partnerships, and informal institution such as the exchange of bilateral high-level leaders and the establishment of Confucius Institutes. Third, this paper adopts the foreign policy similarity data calculated based on the latest United Nations General Assembly(UNGA) voting data as a proxy of bilateral diplomatic relations friendliness between China and other countries[13]. Different from the previous measurement of diplomatic relations from Chinese perspective, the UNGA voting data offers the advantage that the data is available for all states in the international system and for a long time period, it also exhibits a higher level for variance than other foreign relations,thus contains more information on a nation's foreign policy interests[18], which can more objectively quantify the political relations between the two countries.

2 LITERATURE REVIEW AND HYPOTHESIS

2.1 Bilateral Diplomatic Relations and Cross-border M&As

Chinese firms are playing an increasingly important role in cross-border M&A market, but at the same time, the failure rate of cross-border M&A is still high [19]. Existing literature have studied the reasons for the failure of cross-border M&As,which indicate that institutional environment is one of the key factors. The host country's institutional environment has an important impact on corporate behaviour[20,21], since institutions can promote or restrict market transactions by reducing or increasing the transaction costs involved in corporate transactions. International firms need to obey the host country's institutional environment in order to establish legitimacy in the host country and help ensure subsequent business success[22]. In a host country with good institutional environment, the operating environment of the enterprise is better, and the transaction costs and uncertainty to gain profit are reduced, which is beneficial to corporate investment [6]. Secondly, institutional distance between the host country and the home country also affects firms' cross-border M&As. Research shows that the institutional distance between countries has a negative impact on the success rate of cross-border M&As[22]. Greater institutional distance indicates greater uncertainty and unfamiliarity with the local environment, thus increasing the cost of doing business in foreign countries for cross-border firms [23] and making it more difficult for firms to shift strategies and practices among affiliates, and gain legitimacy in foreign markets.

As the failure of cross-border M&As has caused many unnecessary losses to cross-border firms, it is also important for scholars to study what factors can reduce the negative effects of the institutional distance on multinational firms[5,24]. Although the existing studies point out that the institutional environment of the host country and the home country have an important impact on cross-border M & As, few studies consider the impact of the common linkage between the host and the home country on the internationalization of enterprises.In recent years, the internationalization of firms in emerging countries is still developing rapidly without "Ownership advantage". The motivation behind this behavior has aroused widespread concern in the academic, among which the bilateral diplomatic relation is one of the most important driving factors. Bilateral diplomatic relations establish a "bridge" between the host country and the home country institution. Most studies have proved that the friendly political relationship between the investing country and the host country is conducive to the development of OFDI[3,25]. The main theoretical analysis uses the transaction cost and agency theory to analyze the role of international political system and the relationship between countries. First, it is believed that institutional arrangements between countries can reduce uncertainty and help reduce the cost of legal transactions [26]. Friendly bilateral diplomatic relations can promote political mutual trust and reach consensus on cooperation[27], reducing the cost and uncertainty of legal transactions, and providing protection for enterprises' investment in the host country[28]. Moreover, bilateral diplomatic relations can form an external binding force on the host country's institutional risks, indirectly affect cross-border M&As and have some moderating effect on the inherent political, economic, and cultural institutional distances between two countries. On the one hand, when two countries have large institution differences, firms are not familiar with the local market, they encounter difficulties of information searching, communication and negotiation, and legal protection of M&As activities, which will lead to higher costs and greater uncertainty. On the other hand, large institution distance would cause cross-border firms to face difficulties in the internal and external legitimacy of the host country, and higher adaptation and coordination costs[29]. Friendly diplomatic relations are a higher-level institutional arrangement that is conducive to the creation and improvement of various other bilateral rules, which can guarantee the interests of investors, and also helps investors adapt to the host country institution[30]. Therefore, the institutional linkages created by bilateral diplomatic relations can compensate for the institution differences in host country, lower entry barriers for investors of the home country, enhance the legitimacy of investment, reduce the investment risks of multinational enterprises, and increase cross-border M&As' success rate. The hypothesis is proposed:

Hypothesis 1: Bilateral diplomatic relation has a positive impact on the completion rate of cross-border M&As from and to China.

2.2 The Influence Mechanism of Bilateral Diplomatic Relation on Cross-Border M&As

Based on the theory of realism in international relations, the diplomatic relation between the two countries is not only at the political level, but also affect the cooperation in economic and cultural aspects, which can help to create formal and informal institutions linkages between home and host countries. In an economy, there are formal and informal institutions that govern the economic behaviour of firms and the ways in which they interact[20,21]. Formal institutions refer to the rules, laws, and practices of a particular society; informal institutions refer to the implicit values and norms of culture, language, and society[22]. Institutional theory holds that there are significant differences of formal and informal institutions in various countries[31]. Differences of the formal institutions (laws, regulations, etc.) between the home country and the host country, as well as the informal institution (culturally driven), will affect several aspects of cross-border firms entering to overseas market, including the entering method, amount of M&A share, and success rate[21,32]. However, bilateral diplomatic relations can promote the establishment of formal and informal institutions and regulate the institution differences between two countries.

On the one hand, bilateral diplomatic relations will promote the establishment of formal institution between two countries, such as bilateral security alliances, bilateral partnerships or bilateral treaties[30]. Various uncertainties of economic exchanges between countries can be reduced through this relationship, which enhances bilateral trust so as to make it easier for the host country to accept foreign investment[33]. Secondly, the cost for firms to search for potential partners will be lower, because the information asymmetry problem will be alleviated[34]. Furthermore, the uncertainty of transactions can be minimized and the institution risk of investments in host country can be reduced, promoting the smooth development of bilateral economic cooperation. In reality, China responds to bilateral friendly diplomatic relations and joins some important international organizations mainly through establishing partnerships with other countries and signing bilateral investment agreements. On the one hand, partnership relation provides an institutionalized framework for bilateral relations. It is an independent and cooperative relationship between countries based on common interests, common actions, mutual complementarity, and common development. Under this framework, the bilateral relationship can further strengthen cooperation[35]. Studies have shown that bilateral partnerships can increase Chinese investment in host countries[36]. On the other hand, economic cooperation between the two countries will get promoted through bilateral friendly diplomatic relations. In order to obtain the legitimacy of foreign investment and regulate bilateral investment, the two countries will sign Bilateral Investment Treaties (BITs), which will effectively protect the property rights of foreign-owned enterprises in the host government, which brings an important practical impact. By protecting investment property rights and ensuring fair and preferential treatment of foreign investment, BITs have reduced the negotiation and transaction costs of individual firm, protected foreign investment, and promoted bilateral investment between signatory countries [28].

On the other hand, bilateral diplomatic relations will naturally evolve into informal institution, such as immigration resulted from close exchanges between the two countries [37]. It is mainly formed due to the close interaction between two countries, and finally promotes the convergence of bilateral values[30]. The two countries with informal institution enjoy similar languages, institutional structures, and business ideas, which can have a longer-term impact on economic exchanges[30]. In reality, China has established Confucius Institutes in other countries as a platform for bilateral cultural exchanges and Chinese learning, enabling bilateral countries to build bridges of non-governmental exchanges through non-governmental behavior, which is conducive to spreading bilateral cultural exchanges and language learning, and enhance the trust of the people of both countries, to strengthen cooperation between the two countries in various fields [38], thereby promoting the success of cross-border M&As.

Friendly diplomatic relations between two countries can promote more high-level leaders' exchange visits, which is also a form of informal institution. On the one hand, high-level mutual visits release signals of friendly relations between the two countries, enhance understanding, mutual trust and friendship between them, and reduce the security threats posed by political prejudice to corporate investment [39]. On the other hand, during high-level exchanges of visits, direct dialogue and political consultations are used to resolve possible differences in major bilateral interests, which enhances the ability and opportunities for negotiation, bargaining, and even rent-seeking activities, thereby increasing the possibility of economic transactions[33], increasing the confidence of enterprises in long-term investment in the host country, promoting enterprises to invest in the country[40], reducing the risk of enterprise investment and increasing the success rate of cross-border M&A. Thus, the hypothesis is proposed:

Hypothesis 2: Bilateral diplomatic relation influence the completion rate of Chinese cross-border M&As by promoting formal and informal institution linkages.

3 MODEL AND BASIC RESULTS

3.1 Data Sources

We use an unbalanced panel data of 181 countries (or regions) from 1992 to 2017 to empirically test the effect of bilateral diplomatic relations on the completion rate of cross-border M&As from and to China and the effect mechanism. The countries or regions of the sample come from World Bank WDI data.

The data of cross-border M&As comes from the Thomson SDC Platinum. We follow the following procedures in data processing for cross-border M&As. First, we choose China as the home country of the parent firms to get the data of cross-border M&As from China. Second, we choose China as the host country of the parent firms to get the data of cross-border M&As to China. Third, we stipulate that the acquirer is a corporate entity rather than an individual. Fourth, for cross-border M&As from China, we set that the target firm and its parent firm are not Chinese firms, while the parent company of the acquirer is in China, vice versa for cross-border M&As to China. Fifth, acquirers classified as financial firms according to *The Industry Classification Guidelines of Listed Companies*, issued by the CSRC, are excluded and the subject matter of the M&A event is the equity of the target firm, so as to avoid the impact of asset-acquisition events on the research.

The data of bilateral diplomatic relations mainly comes from the latest research of Bailey, Strezhnev & Voeten[4] by using the United Nation General Assembly (UNGA) voting data, which is processed with the Item Response Theory and Dynamic Ordinal Spatial Indicator Model to calculate the ideal point of each country's foreign policy. The ideal point is not binary data, but has specific scores, therefore, the absolute value of the difference between the ideal scores of each country can be used to denote the similarity of the two countries' foreign policy, we re-calculate foreign policy similarity between two countries as a proxy variable reflecting the degree of bilateral diplomatic relations between two countries[41].

3.2 Variables

3.2.1 Dependent variables

The dependent variable $M\&A_{it}$ indicates cross-border M&As in country "*i*" in year "*t*" from China to other countries or from other countries to China. In the database of Thomson SDC Platinum, for every M&A deal, we mainly consider two variables: announced deal and effective deal. Then, by summing up the cross-border M&As from China to a certain country and certain year, we can obtain variables such as the number of completed M&As deals, or the number of M&A announcements, the total value of completed M &As in one year and in one country. We make the same data processing for cross-border M&As from other countries to China.In this paper, we mainly use the number of completed cross-border M&As as a percentage of the number of announced cross-border M&As of country "*i*" in year "*t*" to represent the completion rate of cross-border M&As. In the robustness test, we also use the number of successful M&A cases.

3.2.2 Independent variables

Bilateral diplomatic relation ($forsimilar_{it}$) is the independent variable which indicates the degree of of bilateral diplomatic relation friendliness between China and country "*i*" in year "*t*". We define the variable of bilateral diplomatic relation on the basis of " Ideal Point" of Bailey, Strezhnev & Voeten[4] as $forsimilar = \frac{1}{\ln(|dforpoli - cdforpoli| + 1)}$. As there may $|dforpoli - cdforpoli| = 0$, it is necessary to add 1 and then take logarithm. Larger value of *forsimilar* means more friendly bilateral diplomatic relation.

3.2.3 Control variables

"X" represents control variables. According to Buckley et al.[42] and Kolstad and Wiig[43], three kinds of variables are controlled. The first variable reflects the situation of the host country, including: economic development (real per capita GDP, *lrpgdp*); the industrial structure of the host country (proportion of added value of secondary industry to GDP, *Rwg2*); the openness of the host country (total imports and exports as a proportion of GDP, *open*); the consumption structure of the host country (proportion of final consumption to GDP, *Rconsum*). The second variable reflects the situation of the home country, including: the economic development of the home country (logarithm of China's real GDP per capita, *clrpgdp*), the industrial structure of the home country (proportion of added value of China's secondary industry to GDP, *cRwg2*); the openness of the home country (proportion of total imports and exports to GDP, *copen*); the consumption structure of the home country (final consumption as a proportion of GDP, *cRconsum*). The third variable reflects the relationship between the host and home country, including the import and export relationship (proportion of the total import and export volume to China in the total import and export volume, *Reximc*), the logarithmic of geographical distance between the two capitals of the home and host country (*ldist*), and whether the host country borders China (if the country borders China's territory, it is assigned a value of 1, otherwise the value is 0, *conti*). In addition, we also control the year fixed effect and the individual fixed effect respectively in regression analysis.

4 EMPIRICAL METHODOLOGY

4.1 Model

This paper focuses on the impact of bilateral diplomatic relations on the completion rate of cross-border M&As from and to China. Referring to Gravity Model in international investment of Anderson &Van Wincoop[44] and studies of institutional influence on China's OFDI[42,45], we set the following estimation model:

$$M\&A_{it} = \beta_0 + \beta_1 forsimilar_{it} + X'\lambda + \alpha_i + \eta_t + \varepsilon_{it} \quad (1)$$

In model (1), i represents the country of cross-border M&As from or to China, and t represents the year. The coefficient $\beta 1$ measures the direction and intensity of the bilateral diplomatic relations on cross-border M&As from or to China.

4.2 Basic Results

Based on model (1), the panel data model is established to test the impact of bilateral diplomatic relations on the completion of cross-border M&As from and to China. Table 1 presents the results of basic regression and tables 2 to 4 show the results of different types of robustness tests.

Table 1 Regression Results of Model 1: The impact of Bilateral Diplomatic Relation on the Completion Rate of Cross-Border M&As Completion

	(1)	(2)	(3)	(4)	(5)	(6)
	Cross-border M&As from China			Cross-border M&As to China		
forsimilar	0.347***	0.361**	0.302**	0.101**	0.151**	0.295***
	(0.111)	(0.152)	(0.150)	(0.045)	(0.076)	(0.090)
lrpgdp		3.835***	3.762***		4.458***	4.091***
		(0.578)	(0.283)		(0.271)	(0.196)
Rwg2		-0.143***	-0.158***		-0.196***	-0.158***
		(0.053)	(0.026)		(0.027)	(0.019)
open		0.037**	-0.014		0.030***	-0.006
		(0.019)	(0.011)		(0.006)	(0.006)
Rconsum		0.132***	-0.041*		0.004	0.011
		(0.049)	(0.024)		(0.021)	(0.014)
Reximc		97.487	828.911***		323.374***	415.898***
		(382.869)	(277.200)		(112.720)	(116.918)
ldist			-3.373***			-5.536***
			(0.837)			(0.515)
conti			2.526			-2.155**
			(1.593)			(1.037)
clrpgdp			8.714**			-7.812***
			(4.029)			(2.613)
cRwg2			-1.531**			0.358
			(0.610)			(0.401)
copen			0.011			0.026
			(0.090)			(0.060)
cRconsum			-0.621			-1.016***
			(0.540)			(0.334)
Constant	5.036***	-29.289***	25.501	3.827***	-29.463***	95.552***
	(0.316)	(5.892)	(37.967)	(0.148)	(2.618)	(22.970)
Individual fixed effect	Y	Y	N	Y	Y	N
Year fixed effect	Y	Y	N	Y	Y	N
N	4261	2387	2379	4261	2387	2379
R^2	0.052	0.332	0.161	0.026	0.472	0.281

*Note: (1) ***, ** and * represent significance levels of 1%, 5% and 10% respectively; (2) The standard error is in the small brackets; (3) R^2, N represent goodness of fit and number of individuals respectively.*

In Table 1, the dependent variable of Columns (1)-(3) is the completion rate of cross-border M&As from China to other countries. In Column (1), there are no control variables, Column (2) adds variables reflecting the situation of host countries,we control both year fixed effect and individual fixed effect in Column (1)-(2). Column (3) adds variables reflecting the situation of China and the relationship between the host and the home country,which are geographical distance, whether or not there is a border, and doesn't control year and individual fixed effect. The dependent variable of Columns (4)-(6) is the completion rate of cross-border M&As from other countries to China. For the control variables,we take the same processing as Columns (1)-(3).

We mainly intend to study the coefficient of bilateral diplomatic relation (*forsimilar)*. In Columns (1)-(3), it can be seen that, when different dimensions of control variables are added, the coefficient is significantly positive at least 1%. This indicates that friendlier bilateral diplomatic relations significantly improve the completion rate of Chinese cross-border M&As. In Columns (4)-(5), it can be seen that, the coefficient is also significantly positive at least 1%, which indicates that friendlier bilateral diplomatic relation can significantly improve the completion rate of cross-border M&As to China. The results of the basic regression further verify that friendlier bilateral diplomatic relation can improve the completion rate of cross-border M&As.

4.3 Robustness Test

We conduct robustness tests regarding the regression of Table 1 in Tables 2-4. We use other control variables in the same way as the regression of Column (2) and Column (5) in Table1.

Table 2 Robustness Test: Replace the Dependent Variable

	(1)	(2)	(3)	(4)
	ln(1+ Number of successful M&A cases)			
	Cross-border M&As from China		Cross-border M&As from China	
forsimilar	0.004**	0.005**	0.003***	0.004**
	(0.002)	(0.002)	(0.001)	(0.002)
Constant	0.090***	-0.469***	0.135***	-0.577***
	(0.005)	(0.084)	(0.008)	(0.053)
Other control variables	N	Y	N	Y
Individual fixed effect	Y	Y	Y	Y
Year fixed effect	Y	Y	Y	Y
N	4261	2387	4261	2387
R^2	0.025	0.327	0.226	0.396

*Note: (1) ***, ** and * represent significance levels of 1%, 5% and 10% respectively; (2) The standard error is in the small brackets; (3) R^2, N represent goodness of fit and number of individuals respectively.*

First, in Table 2 we replaced the dependent variable by using the number of successful M&A cases,specifically ln (1+ number of successful M&A cases) as measure of the dependent variable. In Columns (1)-(2) is the the number of successful M&A cases of from China to other countries, Columns (3)-(4) is the the number of successful M&A cases of from other countries to China.The coefficient of (*forsimilar*) in Columns (1)-(2) are significantly positive at least at the level of 5%. The coefficient of (*forsimilar*) in Columns (3)-(4) are significantly positive at least at the level of 1%. The results show that even if the dependent variables are replaced, the conclusion of Table 1 still holds, that is, friendlier bilateral diplomatic relations significantly promotes cross-border M&As from and to China.

Table 3 Robustness Test: Replace the Independent Variable

	(1)	(2)	(3)	(4)
	Cross-border M&As from China		Cross-border M&As to China	
forsimilar2	10.560***	11.004***	3.207***	4.340***
	(2.346)	(2.479)	(0.893)	(1.284)
Constant	-0.108	-37.947***	2.214***	-33.313***
	(1.286)	(6.180)	(0.481)	(2.883)
Other control variables	N	Y	N	Y
Individual fixed effect	Y	Y	Y	Y
Year fixed effect	Y	Y	Y	Y
N	4287	2387	4287	2387
R^2	0.058	0.336	0.028	0.473

*Note: (1) ***, ** and * represent significance levels of 1%, 5% and 10% respectively; (2) The standard error is in the small brackets; (3) R^2, N represent goodness of fit and number of individuals respectively.*

Second, in Table 3 we replaced the independent variable by *forsimilar2* which is defined as $forsimilar2 = \frac{1}{|dforpoli - cdforpoli| + 1}$. In Columns (1)-(2) is completion rate of cross-border M&As from China to other countries, Columns (3)-(4) is the completion rate of cross-border M&As of from other countries to China. The coefficient of (*forsimilar2*) in Columns (1)-(4) are significantly positive at the level of 1%. The results show that even if the independent variables are replaced, the conclusion of Table 1 still holds, that is, friendlier bilateral diplomatic relations significantly promotes cross-border M&As from and to China.

Table 4 Robustness Test: Solving the Endogenous Problem

	(1)	(2)	(3)	(4)	(5)	(6)
	Cross-border M&As from China			Cross-border M&As to China		
VARIABLES	Fixed effect	System GMM	IV estimate	Fixed effect	System GMM	IV estimate
L.forsimilar	0.344**			0.202**		
	(0.158)			(0.080)		
forsimilar		0.122*	4.195***		0.103***	1.277**
		(0.070)	(1.215)		(0.031)	(0.523)
L.M&A		0.050***			-0.026***	
		(0.006)			(0.005)	
Constant	-29.570***		34.702	-29.527***		-3.825
	(6.144)		(31.738)	(2.678)		(17.014)
Individual fixed effect	Y	-	Y	Y	-	Y
Year fixed effect	Y	Y	Y	Y	Y	Y
N	2322	2324	2316	2316	2324	2316

*Note: (1) ***, ** and * represent significance levels of 1%, 5% and 10% respectively; (2) The standard error is in the small brackets; (3) N represent number of individuals respectively.*

Third, considering endogeneity, there may be reverse causality problem,that is, cross-border M&As may influence bilateral diplomatic relations. Based on established methods in the existing literature, we conduct a robustness test. First, we employ the lag term of bilateral diplomatic relation (*L.forsimilar*) as the independent variable. Second, we add the lag term of the completion rate of cross-border M&As (*L.M&A)* as the control variable, which is mainly concerned with the endogeneity problem caused by missing important variables, therefore, systematic GMM estimation method is adopted. Third, we use the lag term of bilateral diplomatic relation (*L.forsimilar*) as the instrumental variable of bilateral diplomatic relation of the current period. The results are shown in Table 4.

The dependent variable of Columns (1)-(3) is the completion rate of cross-border M&As from China to other countries. In Column (1), the lag term of bilateral diplomatic relation (*L.forsimilar*) is used as the independent variable, and the fixed-effect regression method is still adopted. The coefficient is significantly positive at the level of 5%. Column (2) adds the lag term of Chinese firms' cross-border M&As completion rate (L.M&A) as an independent variable. The coefficient of bilateral diplomatic relation is significantly positive at the 10% level. Column (3) uses the lag term of bilateral diplomatic relation (*L.forsimilar*) as the instrumental variable of the current period. The coefficient of bilateral diplomatic relation is also significantly positive at the level of 1%. The dependent variable of Columns (4)-(6) is the completion rate of cross-border M&As from other countries to China. We do the same regression as Columns (1)-(3). The coefficient of bilateral diplomatic relation is significantly positive at least at the 1% level. The above results indicate that friendlier bilateral diplomatic relation can improve cross-border M&As from and to China, which are consistent with the result of Table 1.

5 MECHANISM OF BILATERAL DIPLOMATIC RELATIONe ON CROSS-BORDER M&AS

5.1 Model

This section will examine the mechanism of bilateral diplomatic relation promoting the completion rate of cross-border M&As through both formal and informal institutions. Specifically, we use the mediation effect model as follows:

$$med_{it} = \alpha + \beta_1 forsimilar_{it} + X'\lambda + \varphi_i + \gamma_t + \mu_{it} \tag{2}$$

$$M\&A_{it} = \alpha_2 + \beta_2 forsimilar_{it} + \lambda med_{it} + X'\delta + \varphi_i + \gamma_t + \mu_{it} \tag{3}$$

In model (2)–(3), *med* is a mediation variable which is formal and informal institution. If the mediating effect holds, both conditions must be satisfied. First, β_1 is significant, that is, bilateral diplomatic relation has significant impact on the mediation variable. Second, λ is significant which indicates that there is mediating effect of bilateral diplomatic relation on cross-border M&As. If the above two conditions are satisfied, it can show that bilateral diplomatic relation can improve cross-border M&As through the mediation variables.

5.2 The Mediating Effect of Formal Institution

5.2.1 The mediating effect of Bilateral Investment Treaties (BITs)

BITs is officially signed between two countries to promote, encourage and protect or guarantee international private investment. We construct a dummy variable (*bit)* for BITs as mediation variable. If China signs BITs with a country (region) in a certain year, then *bit* of this year and the following years is assigned 1; otherwise, the value is 0.Table 5 presents the results.

Table 5 The Mediating Effect of Bilateral Investment Treaties(BITs)

	(1)	(3)	(4)

VARIABLES	*BITs(bit)*	Cross-border M&As from China	Cross-border M&As to China
forsimilar	0.005**	0.348**	0.145**
	(0.002)	(0.152)	(0.072)
bit		0.288**	0.335*
		(0.138)	(0.181)
Constant	-1.488***	-29.246***	-29.332***
	(0.205)	(5.847)	(2.660)
Other control variables	Y	Y	Y
Year fixed effect	Y	Y	Y
N	2387	2387	2387
R^2	0.119	0.332	0.472

*Note: (1) ***, ** and * represent significance levels of 1%, 5% and 10% respectively; (2) The standard error is in the small brackets; (3) R^2, N represent goodness of fit and number of individuals respectively.*

In Columns (1), the dependent variable is whether to sign BITs *(bit),* the coefficient of bilateral diplomatic relation (*forsimilar)* is significantly positive at the level of 5%; that is, friendlier bilateral diplomatic relation significantly promotes signing BITs between China and the certain country. Meanwhile, the dependent variables in Columns (2)–(3) are the completion rates of cross-border M&As from China and to China respectively.In Column (2)–(3) we take bilateral diplomatic relation and whether BITs are signed (*bit*) as the independent variable, the coefficients of bilateral diplomatic relation (*forsimilar)* are both significantly positive at the level of 5%, which shows that BITs can improve the success rates of cross-border M&As from and to China.

5.2.2 The mediating effect of bilateral partnership

Existing studies have shown that bilateral partnership can promote cross-border M&As, friendlier bilateral diplomatic relation means better mutual recognition between two countries, which can promote establishing bilateral partnership. Therefore, we take bilateral partnership as a mediation variable to test whether there is mediating effect. We construct a dummy variable of bilateral partnership (*parnter*), if China establish partnership with country *i* in year *t*, the value is 1, otherwise, it is 0. Table 6 shows the results.

Table 6 The Mediating Effect of Bilateral Partnerships

VARIABLES	(1) Bilateral partnership（*parnter*）	(2) Cross-border M&As from China	(3) Cross-border M&As to China
forsimilar	0.019***	0.307**	0.102**
	(0.004)	(0.150)	(0.048)
parnter		8.162***	1.915***
		(1.289)	(0.721)
Constant	-0.521***	-25.036***	-29.868***
	(0.116)	(6.013)	(2.604)
control variable	Y	Y	Y
Year fixed effect	Y	Y	Y
N	2387	2387	2387
R^2	0.478	0.351	0.474

*Note: (1) ***, ** and * represent significance levels of 1%, 5% and 10% respectively; (2) The standard error is in the small brackets; (3) R^2, N represent goodness of fit and number of individuals respectively.*

In Column(1), bilateral partnership is the dependent variable, the coefficient of bilateral diplomatic relation (*forsimilar)* is significantly positive at the level of 1%, indicating that friendlier bilateral diplomatic relation can promote establishing bilateral partnership. The dependent variables in Columns (2)–(3) are the completion rates of cross-border M&As from China and to China respectively. In Column (2)–(3) we take bilateral diplomatic relation and bilateral partnership as the independent variable, the coefficients of bilateral diplomatic relation (*forsimilar)* are both significantly positive at the level of 5%, which shows that the mediating effect of bilateral partnership holds, that is, friendlier bilateral diplomatic relation can improve the completion rate of cross-border M&As from and to China by promoting establishing bilateral partnership.

5.3 The mediating effect of informal institution

5.3.1. The mediating effect of bilateral high-level leaders' visits

We use bilateral high-level leaders' visits as a mediation variable to test whether bilateral high-level leaders' visits have mediating effect. Table 7 shows the regression results.

There are two kinds of bilateral leaders' visits. The first is Chinese national leaders' visits other countries, including the visits of the President of China, the Premier of China's State Council. The second is leaders of other countries who visit China, including Heads of State visiting China (found in the section on "China's Diplomatic Activities" in "China's Diplomacy"). This paper constructs the following dummy variables: The dummy variable of the Chinese President or Premier visiting foreign countries (*cy*), if the Chinese President or Premier visits a country in a certain year, the country will be assigned a value of 1 in that year, otherwise, the value is 0. The dummy variable of the heads of different countries visiting China(*wpy)*, if a head of country visits China in a certain year, the country has a value of 1 in the year otherwise, the value is 0.

Table 7 Mediating Effect of Bilateral High-Level Leaders' Visits

	(1)	(2)	(3)	(4)	(5)	(6)
VARIABLES	China's president or Premier's visit	Foreign heads' visit	Cross-border M&As from China		Cross-border M&As to China	
forsimilar	0.006**	0.009**	0.254*	0.253*	0.124**	0.114**
	(0.003)	(0.004)	(0.152)	(0.151)	(0.056)	(0.047)
cy			7.486***		3.722***	
			(1.414)		(0.869)	
wy				5.120***		1.967***
				(1.076)		(0.652)
Constant	-0.240	-0.865	-27.040***	-29.381***	-28.945***	-29.564***
	(0.700)	(0.543)	(5.715)	(5.856)	(2.580)	(2.608)
Other control variables	Y	Y	Y	Y	Y	Y
Year fixed effect	Y	Y	Y	Y	Y	Y
Individual fixed effect	Y	Y	Y	Y	Y	Y
N	2387	2387	2387	2387	2387	2387
R^2	0.094	0.146	0.346	0.342	0.478	0.474

*Note: (1) ***, ** and * represent significance levels of 1%, 5% and 10% respectively; (2) The standard error is in the small brackets; (3) R^2, N represent goodness of fit and number of individuals respectively.*

In Column (1)-(2), the dependent variables are bilateral high-level leaders' visits, the coefficient of bilateral diplomatic relation (*forsimilar)* is significantly positive at the level of 5%, indicating that friendlier bilateral diplomatic relations can significantly increase bilateral high-level leaders' visits, including China's leaders visiting other countries and other countries' leaders visiting China. In Column (3) - (4), the completion rate of Chinese firms' cross-border M&As is the dependent variable, and we add bilateral diplomatic relation and bilateral high-level leaders' visits including China's leaders visiting other countries and other countries' leaders visiting China respectively in the regression, and the coefficients of bilateral diplomatic relation (*forsimilar)* are both significantly positive at the level of 10%. In Column (5) - (6), the completion rate of cross-border M&As from other countries to China is the dependent variable, and we add bilateral diplomatic relation and bilateral high-level leaders' visits including China's leaders visiting other countries and other countries' leaders visiting China respectively in the regression, the coefficients of bilateral diplomatic relation (*forsimilar*) are both significantly positive at the level of 5%. The above results show that high-level leaders' visits have mediating effect, that is, friendlier bilateral diplomatic relation can improve the completion rate of cross-border M&As of Chinese firms by promoting mutual high-level leaders' visits.

5.3.2 The mediating effect of cultural exchanges

The friendly diplomatic relations between two countries can not only enhance political mutual trust, but also deepen the understanding and trust between the two peoples through official or unofficial cultural exchanges and improving the communication efficiency. We take the Confucius Institute as the proxy variable of cultural exchange and use it as the mediation variable to test whether friendly bilateral diplomatic relations affect the completion rate of cross-border M&As from ant to China through establishing Confucius Institutes.

We construct two major variables for Confucius Institute. First, the logarithm of the Confucius Institute stock (*lconfu_sto*), specifically, *lconfu_sto=ln* (*1+ Confucius Institute stocks*). Second, whether there is a Confucius Institute (*confu_d*), which is a dummy variable. If a host country has a Confucius Institute in a certain year, the value is 1; otherwise, the value is 0 (The Confucius Institute data comes from http://www.hanban.edu.cn/.).

Table 8 Mediating Effect of Cultural Exchanges

	(1)	(2)	(3)	(4)	(5)	(6)
VARIABLES	Logarithm of Confucius Institute	Dummy variable of Confucius	Cross-border M&As from China		Cross-border M&As to China	

	stock	Institute				
forsimilar	0.021***	0.023***	0.189*	0.141**	0.063**	0.092**
	(0.004)	(0.004)	(0.108)	(0.062)	(0.031)	(0.044)
lconfu_sto			8.778***		3.776***	
			(0.730)		(0.472)	
confu_d				9.416***		2.032***
				(1.016)		(0.604)
Constant	-1.485***	-0.592***	-16.249***	-23.714***	-26.331***	-28.980***
	(0.264)	(0.145)	(5.476)	(5.547)	(2.601)	(2.607)
Other control variables	Y	Y	Y	Y	Y	Y
Year fixed effect	Y	Y	Y	Y	Y	Y
Individual fixed effect	Y	Y	Y	Y	Y	Y
N	2387	2387	2387	2387	2387	2387
R^2	0.378	0.433	0.389	0.366	0.493	0.475

*Note: (1) ***, ** and * represent significance levels of 1%, 5% and 10% respectively; (2) The standard error is in the small brackets; (3) R^2, N represent goodness of fit and number of individuals respectively.*

In Columns (1)–(2) of Table 8,the dependent variables are the logarithm of Confucius Institute stock and the Confucius Institute dummy variable respectively. The coefficients of bilateral diplomatic relation (*forsimilar)* is significantly positive at least at the level of 1%, that is, friendlier bilateral diplomatic relation can significantly promote cultural exchanges between the two countries. In Column (3) - (4), the dependent variable is the completion rate of Chinese firms' cross-border M&As, and we add the logarithm of Confucius Institute stock and the Confucius Institute dummy variable respectively in the regression, and the coefficients of bilateral diplomatic relation (*forsimilar*) are both significantly positive at least at the level of 10%. In Column (5) - (6), the dependent variable is the completion rate of cross-border M&As from other countries to China, and we add the logarithm of Confucius Institute stock and the Confucius Institute dummy variable respectively in the regression, and the coefficients of bilateral diplomatic relation (*forsimilar*) are both significantly positive at the level of 5%. The results show that establishing Confucius Institute has mediating effect,that is, friendlier bilateral diplomatic relation can help promoting the establishment of the Confucius Institute, enhancing mutual culture communication, thus, and improves the completion rate of cross-border M&As from and to China.

6 CONCLUSION AND POLICY IMPLICATIONS

By acknowledging the growth of M&As both from and to China and the bilateral diplomatic relation as an important tool to establish a institution linkage between China and other countries,this study, drawing on institutional theory, investigates the impact of bilateral diplomatic relation on the completion rate of cross-border M&As both from China to other countries and from other countries to China. The results show that friendly bilateral diplomatic relation can significantly improve the completion rate of cross-border M&As from China to other countries and from other countries to China. The mechanism test found that bilateral diplomatic relations affect the completion rate of cross-border M&As from China to other countries and from other countries to China through formal and informal institutions. For the formal institution, bilateral diplomatic relations can improve the completion rate of cross-border M&As from and to China by promoting the signing of BITs and the establishment of bilateral partnerships. For the informal institution, bilateral diplomatic relations increase the completion rate of cross-border M&As from and to China by promoting exchanges of high-level bilateral leaders and the establishment of Confucius Institutes.

Our study generates practical implications for the promotion of M&As from China to other countries and from other countries to China. To enhance the success of cross-border M&As from and to China, the Chinese government can take advantage of the successful experience of political diplomacy in creating more opportunities for bilateral political,economic and culture communication to enable people with different institution to understand and trust each other and win public support for deepening bilateral and multilateral cooperation. Moreover, China and other countries can make endeavor to find effective channels to make linkages between countries. The mechanism test in the paper shows the bilateral diplomatic relations can help to improve formal and informal institutions to enhance the success of cross-border M&As from and to China. Therefore, both China and other countries can actively explore bilateral and multilateral cooperation mechanisms to promote the establishment or formulation of new cooperation rules and agreements, for example, by strengthening dialogue between leaders of countries, increasing cultural exchanges with countries around the world.

COMPETING INTERESTS

The authors have no relevant financial or non-financial interests to disclose.

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