

RESEARCH ARTICLE

Reputational risk and target selection: An evidence from China

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[Correction added on 29 August 2024, after first online publication: The second author's first name has been corrected from 'Abubakar' to 'Abubakr' in this version of the article.]

Abstract

Do bidders with pre-deal lower (higher) reputational risk select targets with lower (higher) reputational risk in the existing and new markets? Past research on the role of reputation suggests that reputable firms make conservative investment decisions to maintain their reputation. Using data from the Chinese takeover market over the time period 2010 to 2018, we examine the effect of reputational risk similarity on target selection and bidder returns. The results show that bidders with pre-deal lower (higher) reputational risk select targets with lower (higher) reputational risk and this pattern of target selection only holds in the existing market whilst bidders entering into the new markets select targets with different levels of reputational risk. We also find that bidders with lower reputational risk earn higher announcement returns in both existing and new markets and pay fairer premiums to win the bid auction.

KEYWORDS

announcement returns, M&As, reputational risk, target selection

1 | INTRODUCTION

An important driver of takeover success is post-deal integration – the dexterity with which two discrete firms become one. Post-deal integration is contingent on numerous factors, one of which is the resemblance in resources of merging firms (Cartwright & Cooper, 1993; Chatterjee & Wernerfelt, 1991; Chen et al., 2017; Harrison et al., 2001; Makri et al., 2010; Singh & Montgomery, 1987). Early glimpses into merging firms' resources suggest that the potential of takeover synergies is higher if combining firms have identical resources either tangibles (Chen et al., 2017; Colombo & Rabbiosi, 2014; Miozzo et al., 2016) or intangibles (Bereskin et al., 2018; Kaul & Wu, 2016; Lee et al., 2018; Maung et al., 2020). Although these studies improve our understanding of the resources similarity in mergers and acquisitions

(henceforth, M&As), however, the role of reputational risk¹ in target selection from the existing (both bidders and targets are from the same industry) and new (bidders come from different industries) markets is less explored. Considering the importance² of reputational risk in M&As, this study attempts to answer the following research questions: (i) Do bidders with pre-deal lower (higher) reputational risk select targets with lower (higher) reputational risk in the existing and new markets? (ii) How does the stock market react to these target selections?

The motivation behind this study is rooted in the significance of a firm's reputation in the takeover market. Examining the importance of reputational risk in M&As is a crucial endeavour as it shows a firm's strategic move towards following ethical standards, improving stakeholder trust, and maintaining organizational success

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(Kaul & Wu, 2016). Our focus on China is driven by the following reasons. First, China's takeover market statistics analysis and the Wind database report that the number of Chinese M&As were 2574, including 2355 domestic acquisitions (Zhu & Zhu, 2016). Given the high volume of M&As that have been appearing domestically, it is very important to explore what acquirers look for when selecting targets. Furthermore, M&A deals by Chinese firms have played a dominant role in shifting the organizational trends both in China and in other regions (Alhenawi & Hassan, 2023). Second, the capital market of China has shown rapid growth during the last two decades. Specifically, the Chinese stock market has witnessed an unprecedented surge from 5320.55 billion RMB in 2000 to 43,492.40 billion RMB in 2021 and an important element of this progress is Chinese M&A deals. Third, China is in a transition stage, and, hence, the social culture of the China possesses unique specificities as compared to the M&A deals of the advanced economies that may influence firm's target choice in M&A. For example, consumer sentiment in China is highly influenced by public opinion, consequently, any reputational façade associated with the target firms can jeopardize the acquirer's legitimacy and brand value. The acquirer needs to consider the target's ethical behaviour and associated reputation especially in a domestic acquisition where information asymmetry and post-acquisition challenges are lower (Martynova & Renneboog, 2008; Maung et al., 2020).

Prior research considering the role of reputation in target selection has emphasized the importance of strategic fit between merging firms (i.e., the acquirer and the target) and argued that acquirers tend to target firms having similar reputational risk (Boone & Uysal, 2020; Jensen & Roy, 2008; Kaul & Wu, 2016; Maung et al., 2020; Petkova et al., 2014; Pfarrer et al., 2010; Saxton & Dollinger, 2004). These studies show that reputable acquirers, characterized by low reputational risk, are more likely to buy firms with low reputational risk because such acquirers make conservative decisions to preserve their entrenched reputations. This line of argumentation is prickly in two facets. First, this is not always the case that low-reputational risk firms make conservative decisions as they also experience shareholders' pressure to deliver higher growth and value (Fombrun & Shanley, 1990; Halebian et al., 2006). Therefore, it is plausible that low reputational risk firms select non-similar targets, high reputational risk firms, to tap market potential. Second, the acquirer-target homogeneity assumption has a limited focus because it only considers low reputational risk acquirers and ignores high reputational risk counterparts that may also aim for acquiring low reputational risk targets to benefit from the positive

reputational spillovers. Thus, the question of how reputational risk affects firms' target selection remains unresolved.

We answer this question by distinguishing between levels of reputational risks (low and high) and simultaneously focusing on the context. Drawing on the resource-based view (Barney, 1991; Hart, 2005), this study uncovers the role of reputation risk as an important firm resource in target selection and post-deal bidder performance. Since reputational risk is a distinct resource, bidders may consider the level of the targets' reputational risk to realize synergies and the target selection may depend on the target market – existing or new. Therefore, we need to discern between the level of reputational risk of combining firms (low and high) for target selection and the type of market bidders are entering, simultaneously. It is because the reputational risk analogy between combining firms is positively associated with merger pairs and superior post-deal performance. A salient facet of our hypothesis is that bidders and targets with similar reputational risk will confront limited post-deal integration³ challenges. Bidders with lower pre-deal reputational risk may select targets with lower reputational risk and realize higher announcement returns around the deal.

Acquiring targets with the similar level of reputational risk may only hold in the existing market whereas bidders entering into the new markets may be motivated either to transfer or learn better reputational practices depending on the level of their pre-deal reputational risk.⁴ Studies suggest that dissimilarity between merging firms' resources or capabilities could be an important driver of takeover synergies (Ellis et al., 2017; Hussain & Shams, 2022; Yan & Zhang, 2003). A commonly held view of these studies is that resource/capability differences create room for sharing valuable resources so that the resource-poor firm can deploy and learn from better resources of other firms to realize takeover gains. Therefore, pre-deal resource difference is a way of increasing combined resources and learning from one another.

Using a sample of 1130 Chinese M&As from 2010 to 2018,⁵ we find that overall bidders prefer targets having similar reputational risk – bidders with low (high) reputational risk select targets with low (high) reputational risk. Economically, with one standard deviation increase in bidder's reputational risk score, probabilities for bidders with low reputational risk selecting targets with low risk and bidders with high reputational risk selecting targets with high risk increase by 9.92% and 24.79% points, respectively. Moreover, we manifest that reputational risk preference varies across existing and new markets where bidders prefer similarities between merging firms' reputational risk in the existing market while entering into the

new market they acquire targets with dissimilar levels of reputational risk. We also exhibit that the stock market positively reacts to deals by bidders with lower reputational risk, especially in the existing market, however, the stock market always reacts positively regardless of the bidders' reputational risk in the new market. Our findings suggest that reputational risk is an important determinant of target selection and the lower level of reputational risk is associated with positive bidder announcement returns particularly in the existing market. The reported results are robust to alternative measures of reputational risk and bidder returns, subsamples, and exist after addressing sample selection bias.

Our study makes three important contributions to the target selection literature in M&As. First, we add to the literature showing similarity in terms of resources, technology, organizational practices, ownership, and culture (Bereskin et al., 2018; Bettinazzi et al., 2020; Brielmaier & Friesl, 2023; Hussain & Shams, 2022; Miozzo et al., 2016), by documenting that reputational risk similarity is an additional parameter in the target selection. Importantly, we extend the study of Maung et al. (2020) and Aroui et al. (2019) and suggest that the role of reputational risk is not only important in cross-border deals where extent of information asymmetry is high due to institutional distance between the bidder and the target firms, but it also assumes a vital role in domestic markets that are characterized by limited institutional development and weak regulatory enforcement. Moreover, Maung et al. (2020) are limited only to examine the effect of reputational risk on acquisition premium whereas our study delves into the role of reputational risk in the target selection in the new and existing markets.

Our study also distinguishes from the work of Boone and Uysal (2020) who study the effect of CSR similarities between merger and acquiring firms. Their findings show that acquirers always prefer pairing with firms having similar reputations. Firms with lower reputations are less likely to be both acquirers and targets, and they cause lower stock returns for their merging partners. Our paper, however, provides a new insight that an acquirer's reputational risk preference varies across existing and new markets. Additionally, we show that the stock market always reacts positively regardless of the bidders' reputational risk in the new market. We believe this insight contributes a novel dimension to the existing literature which predominantly suggests acquirers prefer targets with similar reputations and target shareholders may oppose a deal due to potential negative reputational spillovers emanating from low-reputation bidder as it may reduce the value of the target firm relative to acquirers with better (e.g., Bereskin et al., 2018; Boone & Uysal, 2020). However, our findings challenge this

notion, emphasizing the nuanced dynamics of reputational risk preferences in different market contexts.

Second, we extend the target selection literature by adopting a multi-dimensional perspective and simultaneously consider both the level of reputational risk and the context of acquirer and target firms. By so doing, we identify the conditions under which acquirers prefer targets with similar reputational risk and enrich the generalizability of the work by Kaul and Wu (2016) who suggest that target selection may depend on the nature of the target market. Third, we contribute to the studies talking about pre-deal differences in M&As (Ellis et al., 2017; Hussain et al., 2024; Martynova & Renneboog, 2008; Yan & Zhang, 2003). We show that bidders entering into new markets select targets with different levels of reputational risk and these choices are positively rewarded by the stock market, suggesting that portability or learning of better reputational practices is the motive behind such target selections.

The remaining study is arranged as follows: Section 2 presents literature review and develops hypotheses; Section 3 describes data and reports descriptive statistics; Section 4 states methodology; Section 5 shows empirical findings; Section 6 documents robustness tests; Section 7 concludes the study.

2 | LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

2.1 | Theoretical perspective: Resource-based view (RBV)

RBV suggests that a firm's competitive advantage is based on its unique resources and capabilities (Barney, 1991; Hart, 2005). This view implicitly assumes that resources are both heterogeneous across firms and imperfectly mobile (Conner, 1991; Yu et al., 2022) and a firm may develop its existing resources or acquire a bundle of new resources from outside to enhance its internal capabilities (Conner, 1991). Firms' resources include tangible and intangible assets that a firm owns and controls (Haleblian et al., 2017; Lee et al., 2018) and a firm's capability in possessing these resources discriminate it from competitors (Cheng et al., 2014). As an extension to RBV, some studies accentuate dynamic capabilities as the driver of competitive advantage (Teece et al., 1997; Wang & Ahmed, 2007) and contend that a firm's capability to integrate, adapt, and configure enable it to develop competitive advantage. Thus, dynamic capabilities are firm-based characteristics that can be developed over time through interactions between organizational resources (Amit & Schoemaker, 1993).

In the context of M&As, studies suggest that acquirers can make two types of comparisons when acquiring another firm: the degree to which the target firm's resources add value to its current resources (i.e., complementarity) and the degree to which its resources overlap (i.e., similarity) with target resources (Yu et al., 2016). Particularly, studies used RBV to elaborate the role of firm resources similarity on takeover outcomes. For instance, King et al. (2008) argue that targets with technological resources and bidders with marketing resources serve as complements to derive takeover value. Similarly, Testoni (2022) report that target's technological innovative resources generate higher returns to target shareholders. More generally, takeover performance is higher if the resources of merging firms are complementary (Capron & Pistre, 2002; Puranam et al., 2006) because such takeovers reduce integration problems and enhance competitive advantage of merging firms.

Past studies consider reputation as the common indicator of M&A deals. Considering the lens of the resource-based view, the reputation of the target firm significantly affects the acquisition decision of the acquiring firm, particularly in assessing the relevance of the acquirer's resources (Haleblian et al., 2017). Acquiring a firm's reputation is a proven resource avenue for acquiring a firm's future growth (Pfarrer et al., 2010). Reputation develops an interpretative system for various stakeholders, which is considered important for evaluating firm prospects and their alleged likelihood of forecasted outcomes (Basdeo et al., 2006). Following a large corpus of organizational reputation-related studies which suggest a firm's reputation as a sign of its future strategies and outcomes (e.g., Amor & Kooli, 2020; Blagoeva et al., 2020; Capron et al., 2001; Jensen, 1986), we conceptualize acquiring firm's reputation as an important driver of completion of M&A deals. As M&A deals involve the employment of managerial and financial resources to co-opt new skills, it shows a resource deployment prime by an acquiring firm (Basdeo et al., 2006; Blagoeva et al., 2020). Thus, the organizational reputation of the target firm is employed as substantive information to evaluate the M&A decision. Some studies view the acquisition of a firm with a high or similar reputation as an attempt to ensure future profits (Altunbaş & Marqués, 2008; Amor & Kooli, 2020). Nahata (2008) also reported that firms with similar levels of reputation risk are more likely to access public markets efficiently due to enhanced trust and predictability they signal to regulators and investors. Indeed, the homogeneity of reputation risk minimizes the information asymmetry, as it allows for easier comparison of potential risk and prospects of both acquiring and acquirer firms. The similar level of reputation risk in M&A deals not only simplifies the process of evaluation

by various stakeholders but also increases the attractiveness and credibility to investors (Amor & Kooli, 2020; Barney, 1991). Ultimately, such an equalized reputation risk landscape backs a more transparent and stable M&A deal, promoting profitable prospects.

Overall, it is clear that the effects of resource complementarity and similarity found in the prior research are mixed, with little lucidity on when acquiring firm can benefit from complementarity or similarity in resources. Additionally, while existing research has suggested a trade-off between comparisons of resources, empirical evidence on when an acquirer would choose complementarity over similarity when they are entering the existing or new market is unexplored. From the lens of RBV, if the complementarity (similarity) of resources matters in M&As, the acquirer will buy targets with different (similar) resources to realize synergies (Haleblian et al., 2017; King et al., 2008; Puranam et al., 2006). Employing theoretical arguments from RBV, we propose that an acquirer will select a target based on the market they are entering. Central to our proposed hypotheses is the altercation that similarity in resources will be prioritized in the existing market while complementarity will be preferred in the new market.

2.2 | Target selection and similarities in resources of merging firms

Acquisition is an essential vehicle to build firm assets and competitiveness (Saxton & Dollinger, 2004) and acquirers must select targets rationally to achieve takeover synergies (Borochin et al., 2019; Capron & Shen, 2007). A large body of target selection literature shows that similarity explains the selection of target and the outcomes of the merger (see among others, Alhenawi & Hassan, 2023; Bena & Li, 2014; Capron & Shen, 2007; Kaul & Wu, 2016). Within this realm, the resource similarity between the acquirer and target is examined across their R&D capabilities (Yu et al., 2016), production capabilities (Kaul & Wu, 2016), technological relatedness (Makri et al., 2010), and product market overlap (Bena & Li, 2014). In a parallel vein, other work considers the bidder-target similarities along organizational characteristics such as profitability, diversification, industry growth, and geographical scope (Altunbaş & Marqués, 2008; Capron & Shen, 2007; Dos Santos & Zárte, 2015). Finally, some studies envisioned that similarity in organizational strategies and managerial practices are important predictors of target selection (Datta, 1991; Kuriakose & Paul, 2016). A common explanation provided in these studies builds on the synergy argument which suggests that similarity allows acquirer to leverage

synergy in operations and administrative processes which in turn increases the possibility to combine resources and decrease collaborative frictions.

Apart from the similarities in other types of resources, the similarity in reputational risk can also play an important role in the takeover market. Reputational risk is defined as the risk of damage to a firm's reputation due to negative public perception or a failure to meet stakeholders' expectations (Rindova et al., 2006; Zhou & Wang, 2020), echoes a firm's standing within the society and the market domain (Power et al., 2009), and reflects the quality of the assets obtained in a transaction (Saxton & Dollinger, 2004). Bidders are likely to identify and acquire targets possessing a similar level of reputation and the target selection requires the screening of potential targets to assess the strategic and organizational fit, the quality of the target, and the economic value of the acquisition (Bettinazzi et al., 2020). During pre-deal phase, the acquiring firm has to deal with abundant information to compare various targets. However, since acquirers have limited information processing capacity, they gravitate towards information that is more reliable and readily available (Kavuşan et al., 2022). Reputational risk is one such reliable information that is not self-reported rather it is a perception of external stakeholders of the firm and proves credence to the quality of the information. Here, the information generated by a target having similar reputational risk will be more revealing for the acquiring firm due to commonalities in the external reputational challenges and priorities between the two. For example, acquisitions between firms having low reputational risks may give rise to a greater agreement about the type and extent of socially responsible initiatives to maintain their image.

2.3 | Bidder conservatism in M&As

Existing M&A studies show that bidder managers often make conservative investment decisions (Ahmed & Elshandidy, 2016; Elnahas & Kim, 2017; Khurana & Wang, 2019) to preserve the status quo and avoid uncertainty. Based on the attitude towards risk, Schneider and Lopes (1986) classify managers as risk-seekers and risk-averse. Risk-averse managers try to avoid negative consequences whereas risk-seekers look for higher returns. Recently, Kam and Simas (2010) found that risk-averse managers show a higher preference for strategies with specific outcomes than managers with risk-takers. Since M&A outcomes are rarely predictable, certain firm characteristics and acquisition choices can decrease the risk of loss for conservative bidder managers because of greater information availability in acquiring publicly

listed firms, buying targets from the same industry to avoid diversification discount, and paying with stock to rely on their equity.

Well-reputed firms are a specific subset of firms that meet stakeholder expectations of delivering higher performance over time (Petkova et al., 2014; Pfarrer et al., 2010). A firm may establish different levels of reputation with different stakeholders, who may perceive the firm's growth, quality, and value differently (Rindova et al., 2006). Importantly, investors put pressure on well-reputed firms to outperform relative to their poorly-reputed counterparts (Ahmed & Elshandidy, 2016; Fombrun & Shanley, 1990; Halebian et al., 2006). To overcome investors' pressure and maintain a high reputation, reputed firms engage in different acquisition behaviours (Halebian et al., 2017). In the context of our study, firms with lower reputational risk before the deal announcement can make conservative decisions to meet the investors' expectations to deliver higher performance especially when both bidders and targets are from the same industry. Based on the discussion, we develop the following hypothesis:

H1a. The higher the reputational risk similarity between the bidder and target, the higher the probability of selecting a similar target, such that low (high) reputational risk acquirers select low (high) reputational risk targets, *ceteris paribus*.

2.4 | Reputational risk and target market

Resource deployment and resource acquisition are important motives behind M&As (Kaul & Wu, 2016). In resource deployment, acquirers realize value by deploying their existing resources to improve target performance (Bauer & Friesl, 2022; Berchicci et al., 2012). In contrast, resource acquisition enables bidders to create value by acquiring the resources from the target firm and combining these with their existing resources to build up their resource base (Hussain et al., 2024; Kim & Finkelstein, 2009; Rhodes-Kropf & Robinson, 2008). In short, these sources of value creation play an important role in target selection.

Within the reputational risk similarity paradigm, acquirers pursuing resource deployment entails that value from the acquisition deal comes by reducing the target's reputational risk position (improving the target's reputation) as the lower the reputational risk of a target, the greater the potential for improvement. In so doing, acquirers with lower pre-deal reputational risk would

select a target with lower reputational risk. At the same time, acquirers seeking to deploy their reputation to improve the target's risk position will prefer targets operating in the existing markets. Deploying the acquirer's reputation to the target firm will only be valuable if both firms operate in a similar market since only in such a case the acquirer's reputation is useful for the target firm. A reputational asset is more valuable in existing markets as it is cost-effective to deploy resources within a familiar market due to low information asymmetry between acquirer and target firms. Any attempt to use the acquirer's reputation in a new market would not be much helpful for the target firms. Thus, acquiring firms (both with low and high reputational risk firms) tend to prefer targets with similar levels of reputational risk in the existing markets. However, the bidders with higher pre-deal reputational risk may select targets with higher reputational risk in the existing market because both firms are equally notorious in the market and can bargain on better terms due to lower information asymmetries. Also, the reputational asset of the targets in a similar market would not be much valuable for bidder as it would create redundancy problems.

The acquirers looking for resource acquisition to benefit from the target's reputation will prefer targets with low reputational risk in the new market to maximize synergistic value. Here, acquirers with higher pre-deal reputational risk would prefer lower reputational risk targets where the reputational asset of the target is distinct and nonoverlapping to the acquirer. Eventually, higher reputational risk firms seeking reputation building are more likely to prefer targets with low reputational risk in new markets. Another viewpoint on this target selection is that bidders with higher reputational risk may want to learn and adopt better reputational practices from the target. Conversely, bidders with lower reputational risk may prefer to acquire targets with high reputational risk as in that case they can pay a fair price to the target firm for winning the bidding contest and can transfer their better reputational practices to targets. In essence, the difference in pre-deal reputational risk between combining firms is an important factor in target selection in the new market. Based on this discussion, we hypothesize that:

H1b. The acquirers with low (high) reputational risk are more likely to select targets with low (high) reputational risk only in existing market while bidders with low (high) reputational risk prefer targets with high (low) reputational risk in the new market, *ceteris paribus*.

2.5 | Reputational risk and announcement returns

The empirical evidence on announcement returns and takeovers is extensive and inclines towards the idea that bidder shareholders rarely earn positive returns. The key drivers of higher bidder returns include bidders' better governance and CSR practices than targets (Defrancq et al., 2021; Ellis et al., 2017; Hussain & Loureiro, 2022; Hussain & Shams, 2022), takeovers of related industries (Masulis et al., 2007), deal payment in cash (Graham et al., 2002), or acquiring private targets (Fuller et al., 2002). An M&A deal includes two parties, the bidder and the target, and the combining firms differ in terms of resources either tangibles or intangibles.

If the bidders' selection of targets is motivated by enjoying synergy benefits either in the existing market (benefits from resource deployment) or in the new market (benefits emerging from resource utilization through portability – from bidders to targets – or learning of bidders from targets) then these benefits should be reflected in bidder announcement returns. However, the stock market reaction may differ in the existing market when bidders with high reputational risk acquire targets with high reputational risk because such deals may be perceived as value-destroying by the shareholders. Based on the arguments, we develop our second hypothesis as follows:

H2. Higher (lower) bidder announcement returns are associated with lower (higher) level of reputational risk in the existing market and bidders earn higher returns when acquire targets with dissimilar reputational risk in the new market, *ceteris paribus*.

3 | DATA AND DESCRIPTIVE STATISTICS

We used several databases to assemble the group of firms involved in M&As in China. The initial sample of firms engaged in domestic M&A deals in China between 2010 and 2018 is taken from Securities Data Corporation (SDC). The bidders are publicly traded firms with available accounting and stock price data from Refinitiv (Thomson Reuters) WorldScope and DataStream databases, respectively. Our initial sample of domestic Chinese M&As comprises 1875 completed deals. We eliminate 150 deals where the bidder firm is from financials (SIC codes 6000 to 6999) and utilities (SIC codes 4900 to 4949) industries. After using these filters and

TABLE 1 Sample distributions.

Panel A: Sample distribution by deal announcement year	<i>N</i>	%
2010	74	6.55
2011	117	10.35
2012	144	12.74
2013	117	10.35
2014	125	11.06
2015	227	20.09
2016	118	10.44
2017	71	6.28
2018	137	12.12
Total	1130	100.00
Panel B: Sample distribution by bidder industry	<i>N</i>	%
Agriculture	22	1.95
Food products	6	0.53
Soda	5	0.44
Toys	9	0.80
Household consumer goods	3	0.27
Cloths apparel	9	0.80
Healthcare	65	5.75
Drugs	90	7.96
Chemicals	18	1.59
Rubber and plastic products	6	0.53
Textiles	30	2.65
Construction material	10	0.88
Construction	62	5.49
Steel	39	3.45
Machinery	24	2.12
Electric equipment	15	1.33
Automobiles	32	2.83
Mines	12	1.06
Coal	14	1.24
Oil petroleum and natural gas	72	6.37
Gold	26	2.30
Telecommunication	42	3.72
Business services	9	0.80
Computers	47	4.16
Computer software	103	9.12
Electronic equipment	2	0.18
Paper	36	3.19
Transportation	30	2.65
Wholesale	32	2.83
Retail	11	0.97
Meals	6	0.53
Aircraft	112	9.91

(Continues)

TABLE 1 (Continued)

Panel B: Sample distribution by bidder industry	N	%
Real estate	113	10.00
Others	18	1.59
Total	1130	100.00

Note: The table shows sample distributions by year (Panel A) and bidder industry (Panel B). Our sample consists of 1130 completed mergers and acquisitions in the Chinese takeover market reported in the Securities Data Corporation (SDC) from 2010 to 2018.

TABLE 2 Descriptive statistics.

	N	Mean	Median	Standard deviation	Minimum	Maximum	First quartile	Third quartile
Panel A: Reputational risk								
Bidder reputational risk	1130	29.036	27.000	12.582	15.085	78.582	21.042	52.791
Target reputational risk	1130	26.039	25.000	11.837	11.543	48.547	18.271	36.773
Panel B: Existing and new markets								
Same industry	1130	81.500	0.005	0.388	55.965	88.512	27.985	44.258
Panel C: Returns and takeover premium								
Bidder returns	1130	0.046	0.023	0.092	0.015	0.089	0.019	0.056
Takeover premium	1130	-0.038	-0.018	0.068	-0.013	0.975	-0.015	0.478
Panel D: Bidder characteristics								
Leverage	1130	0.114	0.061	0.133	0.045	0.184	0.053	0.122
Firm size	1130	13.925	13.761	1.519	5.482	18.756	9.621	16.258
Profitability	1130	0.060	0.043	0.060	0.023	0.097	0.033	0.070
Sales growth	1130	0.345	0.170	0.919	0.115	0.658	0.142	0.414
Cash Flows	1130	-0.029	-0.015	0.102	-0.010	0.451	0.012	0.218
Tangibles	1130	0.231	0.162	0.211	0.090	0.785	0.126	0.473
Panel E: Deal characteristics								
Target status	1130	0.685	1.000	0.465	0.264	0.759	0.632	0.879
Payment method	1130	0.228	0.001	0.420	0.106	0.455	0.053	0.228
Panel F: Country characteristics								
GDP growth	1130	7.698	7.426	1.114	1.362	9.880	4.394	8.653
GDP per capita	1130	8.898	8.940	0.203	2.340	9.926	5.640	9.433

Note: The table shows summary statistics of all variables used in the study. The sample consists of 1130 completed mergers and acquisitions in the Chinese takeover market reported in the Securities Data Corporation (SDC) from 2010 to 2018. Bidder or target reputational risk is measured using scores provided by RepRisk database. The bidder and target are from the same industry if they share Fama–French 48 industrial category. Bidder returns are cumulative abnormal returns (CARs) over 3-day event window around the deal announcement and takeover premium is the ratio of bidder's offer price to target's stock price 1 week before the deal announcement. Leverage is defined as long-term debt scaled by total assets, firm size is log of book value of total assets, profitability is ratio of earnings before interest and tax to employed capital, sales growth is percentage change in sales from previous to following year, cash flows is computed as operational cash flows minus capital expenditures scaled by total assets, tangibles are calculated as adjusted common stockholder (i.e., equity minus intangible assets) divided by adjusted total assets (total assets minus intangible assets), target status is a binary variable with value of one if target is publicly listed firm and zero otherwise, payment method is a binary variable with value of one for the deals paid in cash and zero otherwise, GDP growth is yearly real GDP growth, and GDP per capita is the natural logarithm of real GDP.

merging SDC dataset with other datasets, we further dropped deals where we do not have missing values on all variables used in the analyses. Our final sample

comprises 1130 deals where 921 deals are in the existing market and 209 deals are in the new market of bidders. An M&A deal is identified as a deal in the existing

TABLE 3 Correlation matrix.

Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	VIF
(1) Bidder reputational risk	1.00												1.04
(2) Target reputational risk	0.38***	1.00											1.25
(3) Bidder leverage	-0.02	0.00	1.00										1.54
(4) Bidder firm size	-0.07	-0.08**	0.33*	1.00									1.41
(5) Bidder profitability	-0.08**	-0.04*	0.47	0.51	1.00								1.01
(6) Bidder sales growth	-0.05	-0.01	-0.06	-0.13*	-0.12*	1.00							1.14
(7) Bidder cash flow	-0.01*	-0.02**	0.02**	-0.08	0.01	-0.05**	1.00						1.32
(8) Bidder tangibles	-0.03*	0.06**	0.33	0.03**	0.17**	-0.13*	0.22**	1.00					1.17
(9) Target status	-0.02	0.00	-0.15**	-0.20	-0.19	-0.06	-0.05	-0.02*	1.00				1.27
(10) Payment method	-0.12**	-0.03*	-0.07	-0.15	-0.09	0.06*	0.11	0.09**	-0.01**	1.00			1.63
(11) GDP growth	-0.12*	-0.03	-0.07*	-0.19*	-0.09*	-0.00	-0.04*	-0.02	0.19	-0.16**	1.00		1.19
(12) GDP per capita	0.13	0.02	0.03	0.13	0.08	-0.02	0.09	0.05	-0.33	0.15	-0.88	1.00	1.51

Note: The table shows correlation among all variables involved in the analyses. The sample consists of 1130 completed mergers and acquisitions in the Chinese takeover market reported in the Securities Data Corporation (SDC) from 2010 to 2018. Bidder or target reputational risk is measured using scores provided by RepRisk database. Leverage is defined as long-term debt scaled by total assets, firm size is log of book value of total assets, profitability is ratio of earnings before interest and tax to employed capital, sales growth is percentage change in sales from previous to following year, cash flows is computed as operational cash flows minus capital expenditures scaled by total assets, tangibles are calculated as adjusted common stockholder (i.e., equity minus intangible assets) divided by adjusted total assets (total assets minus intangible assets), target status is a binary variable with value of one if target is publicly listed firm and zero otherwise, payment method is a binary variable with value of one for the deals paid in cash and zero otherwise, GDP growth is yearly real GDP growth, and GDP per capita is the natural logarithm of real GDP.

market if the involved firms (i.e., the bidder and the target) share the same Fama–French 48 industrial category and otherwise the deal is considered in the new market. To identify bidders or targets with lower or higher reputational risk, we use sample median as a cut-off and involved firms having reputational risk scores below the median value are defined as lower reputational risk firms and vice versa.⁶ We define all variables in Appendix A.

Table 1 reports the sample distributions by announcement year (Panel A) and bidder industry (Panel B). The most active years in the domestic takeover activity of Chinese firms are 2015 (227 deals), 2012 (144 deals), and 2018 (137 deals). Overall, we observe a mixed trend in the Chinese takeover market where the number of deals is increasing till 2012, declining in 2013 and 2014, and sharply increasing in 2015. Panel B of Table 1 shows that the bidder industries with the higher number of deals include real estate, aircraft, and computer software with 113, 112, and 103 deals, respectively.

Table 2 shows descriptive statistics of variables used in the regression analyses, and for all variables, we find substantial dispersion. Panel A of Table 2 shows that the average bidder's and target's reputational risk scores are 29 and 26, respectively, showing that on average bidders have higher reputational risk than targets before the deal announcement. Panel B of Table 2 reports that most M&A domestic deals happen in the existing market (81.50%) than in the new market. Panel C of Table 2 shows that the average bidder's 3-day cumulative abnormal return and takeover premium are 4.62%, −3.85%, respectively, consistent with prior work suggesting that bidder shareholders earn positive returns and pay lower premiums in M&As (Ellis et al., 2017; Hussain et al., 2022; Hussain & Shams, 2022). Panel D of Table 2 presents that the average values for bidder leverage, size, profitability, sales growth, cash flows, tangibles are 0.11, 13.92, 0.06, 0.34, −0.02, 0.23, respectively. Panel E of Table 2 presents binary variables for target status and payment method. We find that 68.50% deals appear between publicly traded bidders and publicly traded targets, and 22.80% deals were paid in cash. Panel F of Table 2 shows that average GDP growth of China is 7.69 and GDP per capita is 8.89.

To examine the correlation between reputational risk and other variables, we present Pearson correlation matrix (Table 3). The first column shows the correlation of bidder reputational risk with other variable, and the second column provides the correlation of target reputational risk with involved variables. Overall, we find that bidder reputational risk is negatively correlated with other variables except GDP per capita.

4 | METHODOLOGY

4.1 | Target selection

To test our first set of hypotheses (H1a and H1b), we used the following probit model:

$$\begin{aligned} Pr(TRS)_{d,t-1} = & \alpha + \beta_1 BRS_{d,t-1} + \sum \beta_x Firm\ controls_{b,t-1} \\ & + \sum \beta_y Deal\ controls_{d,t} \\ & + \sum \beta_x Country\ controls_{c,t-1} + \lambda_t \\ & + \eta_i + \gamma_c + \varepsilon_{i,t} \end{aligned} \quad (1)$$

where $TRS_{d,t-1}$ is a dummy variable that equals one if the target's reputational risk is below the targets' sample median and zero otherwise, for deal d and 1 year before the takeover announcement; α presents the intercept; $BRS_{d,t-1}$ is a dummy variable that equals one if the bidder's reputational risk is below the bidders' sample median and zero otherwise, for deal d and 1 year prior to the deal announcement. We estimate Equation (1) using six model specifications such as: low to low; both bidder and target have lower levels of reputational risk; high to high, bidder and target firms have higher levels of reputational risk; low to low in the existing market, bidder and target firms have lower levels of reputational risk and deal occurs in the similar industry of merging firms; high to high in the existing market, bidder and target firms have higher levels of reputational risk and deal occurs in the similar industry of merging firms; low to high in the new market, bidder has lower level of reputational risk, target has higher reputational risk, and deal occurs between firms from the different industries; high to low in the new market, bidder has higher level of reputational risk, target has lower reputational risk, and deal occurs between firms from the different industries.

$Firm\ controls_{b,t-1}$ is a vector of firm-related characteristics for bidder b 1 year prior to the deal announcement and includes leverage, firm size, profitability, sales growth, cash flows, and tangibles. $Deal\ controls_{d,t}$ is a vector of deal-related characteristics for deal d at time t and includes target status; a binary variable with value of one if the target is a publicly listed firm and zero otherwise; payment method, a binary variable having value of one if the deal is paid purely in cash and zero otherwise. $Country\ controls_{c,t-1}$ is a vector of country-related characteristics for the 1 year before the deal including Gross Domestic Product (GDP) growth and log GDP per capita. We add dummies for year, λ_t , industry, η_i , and country, γ_c to control for omitted factors that can affect our

dependent variable. Finally, to mitigate the effect of outliers, we winsorized firm-related control variables by 1% of their distribution tails.

4.2 | Bidder cumulative abnormal returns (CARs)

The takeover value must be reflected in the announcement returns if an M&A deal is unanticipated. We hypothesize that stock market positively react to deals by bidders with lower reputational risk both in existing and new markets while bidders with higher reputational risk earn lower returns in existing market and higher returns in new market. The underlying reason is better bargaining power of bidders with lower reputational risk translated into lower takeover premia. To estimate the expected returns, we use the following market model:

$$R_{bt} = \alpha_b + \beta_b R_t + \varepsilon_{bt}, t = -255, \dots, -25 \quad (2)$$

where R_{bt} is the daily DataStream return for the bidder b ; R_t denotes the daily market index return; ε_{bt} represents the excess return. Following Fama et al. (1969) standard event study methodology, we use an estimation window of 255 to 25 days before the deal announcement and compute bidders' cumulative abnormal returns for 5-day ($t-2, t+2$) event window. The difference between expected and actual daily returns is the cumulative abnormal return. We use the following model to test our second hypothesis (H2):

$$\begin{aligned} CAR(-2, +2)_{d,t} = & \alpha + \beta_1 BRS_{d,t-1} + \sum \beta_x Firm\ controls_{b,t-1} \\ & + \sum \beta_y Deal\ controls_{d,t} \\ & + \sum \beta_x Country\ controls_{c,t-1} \\ & + \lambda_t + \eta_i + \gamma_c + \varepsilon_{i,t} \end{aligned} \quad (3)$$

where $CAR(-2, +2)_{d,t}$ shows the bidder's cumulative abnormal return around the 5-day event window for deal d ; α presents the intercept. All independent variables are same as in Equation (1) and we winsorized CARs by 1% of their distribution tails.

4.3 | Reputational risk of combining firms and nature of markets

We used reputational risk score provided by RepRisk database that is widely used in the literature (see among others, Asante-Appiah, 2020; Hasan et al., 2022; Maung

et al., 2020). RepRisk provides a percentage score (from 0 to 100) of a firm's reputational risk exposure to environmental, social, and governance (ESG) issues. This scores has been calculated with the combination of artificial intelligence and human intelligence for actionable research. Further, the score changes over time and reflects the accurate level of reputational risk of a firm. We identify bidders and targets with lower (higher) reputational risk if their reputational risk score are below (higher) than sample medians. In our robustness tests, we also used tercile and quintile⁷ distributions to identify bidders/targets with lower or higher reputational risks. We use Fama–French 48 industrial categories to identify whether a deal appears in the existing or new market. An M&A deal occurs in the existing market if the bidder and the target share the similar Fama–French 48 industry, otherwise deal is considered in the new market.

4.4 | Control variables

We use three sets of control variables that may affect returns or acquisition choices: bidder characteristics, deal characteristics, and country characteristics.⁸

The bidder characteristics that we control for include leverage (Lang et al., 1991), firm size (Moeller et al., 2004), profitability (Palepu, 1986), sales growth (Tunyi, 2021), cash flows (Martynova & Renneboog, 2008), and tangibles (Tunyi, 2021). Higher level of leverage minimizes managerial empire-building behaviour (Lang et al., 1991), incentivizes managers to increase firm performance (Gilson, 1990), and increases returns to bidder shareholders (Wang & Xie, 2009). The bidder's firm size can affect target selection (Wang & Zajac, 2007) and announcement returns (Moeller et al., 2004) because such firms has certain acquisition choices and pay higher premiums. Well-performing bidder managers (proxied by profitability) can select targets having growth potential and can generate takeover value (Boubakri et al., 2016; Palepu, 1986). Guo et al. (1995) argue that bidder firms having higher growth efficiently evaluate targets and earn higher announcement returns. Jensen (1986) find that acquiring firm managers with higher levels of cash flows invest in project producing negative net present value. Firms with more tangible assets can use them as collateral security and can raise money for M&As (Tunyi & Ntim, 2016), suggesting that bidders with more tangibles select undervalued targets to show positive takeover performance.

To avoid higher information asymmetries associated with private targets, bidders prefer public targets than private targets (Capron & Shen, 2007). However, M&As of private target firms produce higher returns for bidders (Fuller et al., 2002). Existing studies show that bidder's

payment in stock negatively affects returns due to adverse selection problem (Myers & Majluf, 1984). A country's economic development can impact profits generated by firms (Díaz et al., 2009). Since Gross Domestic Product (GDP) growth and GDP per capita capture a country's level of development, they can impact bidder announcement returns (Gleason et al., 2005).

5 | EMPIRICAL FINDINGS

5.1 | Bidder reputational risk and target selection

We estimate Equation (1) to examine the effect of bidder's reputational risk on likelihood to acquire target

TABLE 4 Reputational risk and likelihood to acquire.

	Full sample		Existing market		New market	
	(1) Low to low	(2) High to high	(3) Low to low	(4) High to high	(5) Low to high	(6) High to low
<i>Reputational risk</i>	0.789*** (9.322)	1.971*** (18.800)	1.096*** (11.845)	2.572*** (17.144)	1.157*** (4.462)	1.075*** (5.041)
<i>Bidder leverage</i>	-0.234 (-0.513)	-0.634 (-1.213)	-0.283 (-0.634)	-0.218 (-0.398)	0.024 (0.027)	0.199 (0.225)
<i>Bidder firm size</i>	0.033 (0.835)	-0.048 (-1.072)	-0.000 (-0.011)	0.036 (0.835)	-0.043 (-0.374)	-0.071 (-0.629)
<i>Bidder profitability</i>	0.959 (1.014)	0.156 (0.146)	-0.777 (-0.783)	0.969 (0.807)	-5.805** (-2.197)	-3.605 (-1.346)
<i>Bidder sales growth</i>	-0.005 (-0.098)	0.039 (0.750)	-0.058 (-1.180)	0.064 (1.146)	-0.226* (-1.837)	-0.141 (-1.089)
<i>Bidder cash flows</i>	-0.014 (-0.032)	-0.036 (-0.070)	-0.618 (-1.426)	0.493 (0.952)	-1.569 (-0.997)	-2.534 (-1.561)
<i>Bidder tangibles</i>	-0.769*** (-2.589)	0.452 (1.326)	-0.197 (-0.795)	0.414 (1.377)	0.522 (1.115)	0.955** (1.994)
<i>Target status</i>	-0.104 (-0.976)	0.315*** (2.598)	-0.059 (-0.482)	0.060 (0.405)	0.051 (0.218)	0.395* (1.682)
<i>Payment method</i>	-0.084 (-0.916)	0.230** (2.207)	-0.237** (-2.288)	0.395*** (3.317)	-0.402* (-1.881)	-0.108 (-0.498)
<i>GDP growth</i>	0.585* (1.809)	-0.669* (-1.783)	0.547 (1.501)	-0.645 (-1.439)	-0.808 (-1.153)	-1.234* (-1.700)
<i>GDP per capita</i>	0.000* (1.699)	-0.001* (-1.787)	0.000 (1.479)	-0.001 (-1.496)	-0.000 (-0.918)	-0.001* (-1.685)
Constant	-8.312* (-1.842)	8.787* (1.670)	-8.056 (-1.576)	7.828 (1.246)	10.348 (1.058)	17.143* (1.695)
Year & industry FE	Yes	Yes	Yes	Yes	Yes	Yes
<i>N</i>	1130	1130	921	921	209	209
Pseudo <i>R</i> ²	0.1094	0.3393	0.1430	0.4263	0.1843	0.2016

Note: The table shows results for the likelihood of bidders with lower/higher reputational risk to acquire targets with lower/higher reputational risk. We define bidders or targets with lower reputational risk if their scores provided by RepRisk database are below the median value and vice versa. The sample comprises 1130 completed mergers and acquisitions in the Chinese takeover market reported in the Securities Data Corporation (SDC) from 2010 to 2018. The bidder and target belong to the existing market if they share the same Fama–French 48 industrial category. Leverage is defined as long-term debt scaled by total assets, firm size is log of book value of total assets, profitability is ratio of earnings before interest and tax to employed capital, sales growth is percentage change in sales from previous to following year, cash flows is computed as operational cash flows minus capital expenditures scaled by total assets, tangibles are calculated as adjusted common stockholder (i.e., equity minus intangible assets) divided by adjusted total assets (total assets minus intangible assets), target status is a binary variable with value of one if target is publicly listed firm and zero otherwise, payment method is a binary variable with value of one for the deals paid in cash and zero otherwise, GDP growth is yearly real GDP growth, and GDP per capita is the natural logarithm of real GDP. All probit models use year and industry fixed effects. *, **, and *** show statistical significance at 10%, 5%, and 1% level, respectively. In parentheses are *t*-statistics and the White (1980) robust standard errors are used for heteroscedasticity. **p* < 0.1; ***p* < 0.05; ****p* < 0.01.

with similar level of reputational risk. Our results from the probit models are shown in Table 4.

In Models (1) and (2) of Table 4, we use full sample of M&As and find that bidders with lower (higher) reputational risk are more likely to acquire targets with lower (higher) reputational risk, corroborating H1a. Economically, probabilities for bidders with low reputational risk selecting targets with low risk and bidders with high reputational risk selecting targets with high risk are higher by 0.78% and 1.97%, respectively, and these magnitudes are statistically significant at 1% level. We further dichotomize our sample into existing and new market and re-estimate Equation (1) for subsamples. Our results in Models (3) and (4) suggest that the reported target choice holds in the existing market – bidders with lower reputational risk before the deal announcement select targets with lower reputational risk and vice versa. When bidders enter in new markets, they have different target selections. The results from Models (5) and (6) show that bidders with lower (higher) reputational risk select targets with higher (lower) reputational risk and the probabilities for these selections are higher, suggesting that reputational risk preference varies across existing and new markets. Among the control variables, we find qualitatively similar results what other authors find (Faff et al., 2019; Hussain & Shams, 2022).

The findings of the study support Resource Based View (Barney, 1991; Hart, 2005) and the importance of resources similarity in M&As (Boone & Uysal, 2020; Haleblan et al., 2017) by examining the association between reputational risk and target selection. Our results are in alignment with the extant literature (e.g., Blagoeva et al., 2020; Chen et al., 2023; Reuer et al., 2004; Saxton & Dollinger, 2004) which identified the level of the target firms' reputation as a critical determinant in the M&A deals. Contextually, our results also support our hypothesized effect that homogeneity in the reputation risk of target and acquirer is a vital factor in M&A deals due to its significant impact in facilitating smoother integration, strategic alignment, and managing the perception of all stakeholders. Firms with equal levels of reputation are more likely to operate and adhere to operational and ethical contextual values without encountering integration hurdles and cultural clashes (Chen et al., 2023). In addition, parity of reputational risk is determinantal in building the legitimacy of the newly formed entity in the organizational field because investors, customers, and other stakeholders may view the M&A deal more positively, thus supporting stability and market confidence. This alignment is vital for minimizing risk, maintaining brand worth, and ensuring that the merged entity can achieve its objectives while ensuring the trust and loyalty of various stakeholders.

We find that bidders have certain target preferences including level of reputational risk but only in the existing market because bidder managers make conservative decisions to maintain their established reputation (Ahmed & Elshandidy, 2016; Elnahas & Kim, 2017; Khurana & Wang, 2019). However, bidders' choices differ when they enter into the new markets because the intentions behind entrance in the new market can be either seeking of firm growth as proposed by Haleblan et al. (2017) or transferability of better firm practices Ellis et al. (2017). The pre-deal differences in firm characteristics between bidders and targets create a room for knowledge transfer (for instance, Björkman et al., 2007; Sarala & Vaara, 2010). In cases, when bidders have better pre-deal CSR practices or resources than targets, they can transfer such practices to targets after the acquisition (Ellis et al., 2017; Hussain & Shams, 2022; Wang & Xie, 2009). Conversely, when targets are better than bidders before the acquisition in terms of resources, governance, or CSR standards, it will provide an opportunity for bidders to learn from targets post-acquisition (Martynova & Renneboog, 2008; Starks & Wei, 2013). In short, we argue that bidders' selection of targets' is not straightforward and somehow depends on the type of market they are entering either with motive of resource deployment or acquisition.

We further test whether target status (i.e., public vs. private), target size, and growth affect the association between bidders' reputational risk and target selection. The rationale behind this analysis is that acquiring publicly listed firms can be value-enhancing decision than acquiring private firms (Fuller et al., 2002; Officer, 2007); takeovers of bigger targets bring financial and operating benefits (Healy et al., 1992); targets with higher growth potential are preferred by bidder managers (Dong & Doukas, 2021). We find that results on reported association between bidder's reputational risk and target selection are more pronounced if bidders acquire private targets than public targets (Models (1) to (4) of Table 5), suggesting that acquiring public target is more relevant for target selection both in existing and new markets. In Models (5) to (12) of Table 5, we show that bigger target size and higher target firm growth are more prevalent in the existing market.

5.2 | Bidder reputational risk, cumulative abnormal returns, takeover premium, and operating performance

The bidders' selection of targets should be reflected in the stock price of the bidder firm. In other words, stock market should either positively or negatively react to choices

TABLE 5 Reputational risk and target characteristics.

	Existing market		New market		Existing market		New market		Existing market		New market	
	(1) Low to low	(2) High to high	(3) Low to high	(4) High to low	(5) Low to low	(6) High to high	(7) Low to high	(8) High to low	(9) Low to low	(10) High to high	(11) Low to high	(12) High to low
<i>Rep. risk</i>	-0.911*** (-2.630)	1.395*** (2.603)	0.107 (0.251)	-0.262 (-0.616)								
<i>Target status</i>	-2.523*** (-7.612)	0.132 (0.832)	-0.453 (-0.699)	0.054 (0.121)								
<i>Rep. risk × target status</i>	2.255*** (6.259)	3.225** (2.183)	1.836*** (2.608)	2.293*** (4.172)								
<i>Rep. risk</i>					-0.809*** (-3.157)	1.468*** (3.360)	1.416*** (3.540)	-1.478*** (-4.223)				
<i>Higher growth</i>					-3.035*** (-11.360)	0.317* (1.939)	0.287 (0.484)	-0.682 (-1.343)				
<i>Rep. risk × higher growth</i>					2.255*** (8.033)	3.268*** (2.720)	-0.382 (-0.657)	0.317 (0.656)				
<i>Rep. risk</i>									-0.941*** (-3.917)	0.823** (2.337)	1.298** (2.537)	-1.509*** (-3.298)
<i>Bigger target</i>									-3.148*** (-11.980)	0.392** (1.999)	0.419 (0.606)	-0.990 (-1.529)
<i>Rep. risk × bigger target</i>									2.399*** (8.834)	2.718*** (5.320)	-0.084 (-0.135)	0.341 (0.629)
Control variables	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year & industry FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Constant	-2.177 (-0.367)	7.855 (1.232)	7.581 (0.629)	1.741 (0.126)	-0.087 (-0.015)	3.012 (0.441)	7.090 (0.606)	-6.725 (-0.529)	-6.388 (-1.076)	4.273 (0.604)	9.079 (0.759)	-7.887 (-0.601)
N	921	921	209	209	921	921	209	209	921	921	209	209
Pseudo R ²	0.2445	0.4312	0.2770	0.3853	0.3391	0.4585	0.2279	0.2640	0.3440	0.4812	0.2283	0.2660

Note: This table presents results for the likelihood of bidders with lower/higher reputational risk to acquire targets with lower/higher reputational risk when targets are privately owned firms, have higher growth opportunities, and have greater firm size. We define bidders or targets with lower reputational risk if their scores provided by RepRisk database are below the median value and vice versa. The sample comprises 1130 completed mergers and acquisitions in the Chinese takeover market reported in the Securities Data Corporation (SDC) from 2010 to 2018. The bidder and target belong to the existing market if they share the same Fama-French 48 industrial category. Control variables are the same as in the previous table. All probit models use year and industry fixed effects. *, **, and *** show statistical significance at 10%, 5%, and 1% level, respectively. In parentheses are *t*-statistics and the White (1980) robust standard errors are used for heteroscedasticity. **p* < 0.1; ***p* < 0.05; ****p* < 0.01.

TABLE 6 Reputational risk, bidder returns, takeover premium, and bidder operating performance.

Dependent variables:		Bidder returns and takeover premium											
		Bidder returns						Takeover premiums					
		Full sample		Existing market		New market		Full sample		Existing market		New market	
(1) Low to low	(2) High to high	(3) Low to low	(4) High to high	(5) Low to high	(6) High to low	(7) Low to low	(8) High to high	(9) Low to low	(10) High to high	(11) Low to high	(12) High to low		
<i>Reputational risk</i>	0.020*** (4.825)	-0.017*** (-4.121)	0.024*** (5.089)	-0.015*** (-2.936)	0.017* (1.846)	0.019** (2.155)	-0.020*** (-4.825)	0.017*** (4.121)	-0.024*** (-5.089)	0.014*** (2.936)	-0.017* (-1.846)	-0.019*** (-2.155)	
<i>Bidder leverage</i>	-0.008 (-0.403)	-0.000 (-0.015)	0.006 (0.252)	0.010 (0.406)	0.052* (1.958)	0.105* (1.927)	0.008 (0.403)	0.000 (0.015)	-0.006 (-0.252)	-0.010 (-0.406)	-0.051* (-1.958)	-0.104* (-1.927)	
<i>Bidder firm size</i>	-0.009*** (-4.868)	-0.008*** (-4.468)	-0.009*** (-4.354)	-0.009*** (-4.092)	0.003 (0.683)	-0.001 (-0.174)	0.009*** (4.868)	0.008*** (4.468)	0.009*** (4.354)	0.008*** (4.092)	-0.002 (-0.683)	0.001 (0.174)	
<i>Bidder Profitability</i>	0.070 (1.485)	0.063 (1.331)	0.082 (1.469)	0.088 (1.559)	-0.199*** (-2.686)	-0.082 (-0.669)	-0.069 (-1.485)	-0.062 (-1.331)	-0.081 (-1.469)	-0.087 (-1.559)	0.197*** (2.686)	0.081 (0.669)	
<i>Bidder sales growth</i>	0.001 (0.316)	0.001 (0.556)	0.001 (0.447)	0.002 (0.722)	0.001 (0.335)	0.003 (0.514)	-0.001 (-0.316)	-0.001 (-0.556)	-0.001 (-0.447)	-0.002 (-0.722)	-0.001 (-0.335)	-0.003 (-0.514)	
<i>Bidder cashflows</i>	-0.057** (-2.345)	-0.054** (-2.225)	-0.060** (-2.251)	-0.057** (-2.082)	0.009 (0.206)	0.087 (1.194)	0.056** (2.345)	0.054** (2.225)	0.060** (2.251)	0.056** (2.082)	-0.009 (-0.206)	-0.086 (-1.194)	
<i>Bidder tangibles</i>	0.001 (0.080)	0.002 (0.150)	0.007 (0.380)	0.003 (0.152)	-0.003 (-0.130)	0.029 (0.627)	-0.001 (-0.080)	-0.002 (-0.150)	-0.007 (-0.380)	-0.003 (-0.152)	0.003 (0.130)	-0.029 (-0.627)	
<i>Target status</i>	-0.000 (-0.001)	-0.000 (-0.094)	-0.010 (-1.570)	-0.009 (-1.374)	0.009 (0.955)	0.019 (1.523)	0.000 (0.001)	0.000 (0.094)	0.010 (1.570)	0.009 (1.374)	-0.009 (-0.955)	-0.019 (-1.523)	
<i>Payment method</i>	0.012** (2.544)	0.013*** (2.881)	0.012** (2.202)	0.016*** (2.815)	0.004 (0.509)	-0.003 (-0.324)	-0.011** (-2.544)	-0.013*** (-2.881)	-0.012** (-2.202)	-0.016*** (-2.815)	-0.004 (-0.509)	0.003 (0.324)	
<i>GDP growth</i>	-0.011 (-0.910)	-0.012 (-1.074)	-0.007 (-0.467)	-0.006 (-0.438)	-0.021 (-0.975)	-0.014 (-0.536)	0.010 (0.910)	0.012 (1.074)	0.007 (0.467)	0.006 (0.438)	0.021 (0.975)	0.014 (0.536)	
<i>GDP per capita</i>	-0.000 (-1.478)	-0.000* (-1.650)	-0.000 (-1.054)	-0.000 (-1.041)	-0.000 (-0.426)	-0.000 (-0.098)	0.000 (1.478)	0.000* (1.650)	0.000 (1.054)	0.000 (1.041)	0.000 (0.426)	0.000 (0.098)	
Constant	0.313** (2.000)	0.342** (2.203)	0.282 (1.414)	0.281 (1.424)	0.177 (0.577)	0.149 (0.394)	-0.310** (-2.000)	-0.339** (-2.203)	-0.280 (-1.414)	-0.278 (-1.424)	-0.176 (-0.577)	-0.147 (-0.394)	

(Continues)

TABLE 6 (Continued)

Panel A: Bidder returns and takeover premium																		
Bidder returns			Takeover premiums															
Dependent variables:	Full sample			Existing market			New market			Full sample			Existing market			New market		
	(1) Low to low	(2) High to high	Yes	(3) Low to low	(4) High to high	Yes	(5) Low to high	(6) High to low	Yes	(7) Low to low	(8) High to high	Yes	(9) Low to low	(10) High to high	Yes	(11) Low to high	(12) High to low	Yes
Year & industry FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	1130	1130	921	921	921	209	209	1130	1130	1130	921	921	921	921	209	209	209	209
Adjusted R ²	0.194	0.189	0.213	0.198	0.198	0.159	0.352	0.194	0.189	0.189	0.198	0.213	0.198	0.159	0.352	0.159	0.352	0.352
Panel B: Bidder operating performance																		
ROA																		
Dependent variables	Full sample			Existing market			New market			Full sample			Existing market			New market		
	(1) Low to low	(2) High to high	Yes	(3) Low to low	(4) High to high	Yes	(5) Low to high	(6) High to low	Yes	(7) Low to low	(8) High to high	Yes	(9) Low to low	(10) High to high	Yes	(11) Low to high	(12) High to low	Yes
Reputational risk	0.012*	-0.019***	0.016**	-0.017**	0.015*	0.019**	0.015*	0.011**	-0.018***	0.015**	-0.016***	0.015**	-0.016***	0.010**	0.010**	0.017*	0.017*	0.017*
Control variables	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year & industry FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Constant	-0.374	-0.347	-0.538	-0.495	0.193	0.147	0.193	-0.352	-0.326	-0.512	-0.470	-0.512	-0.470	0.149	0.177	0.177	0.177	0.177
N	1130	1130	921	921	921	209	209	1130	1130	921	921	921	921	209	209	209	209	209
Adjusted R ²	0.341	0.345	0.377	0.211	0.211	0.352	0.304	0.340	0.343	0.377	0.211	0.377	0.211	0.352	0.352	0.352	0.352	0.352

Note: Panel A shows results for the effect of bidders' reputational risk on the bidders' cumulative abnormal returns (CARs) using 3-day event window and takeover premiums (ratio of bidder's offer price to target's stock price 1 week before the deal announcement). Using Fama et al. (1969) standard event study methodology, we calculate returns using the market model for the estimation window of -250 to -25 days before the deal announcement. Panel B shows results for the impact of bidders' reputational risk on the bidders' operating performance. The sample comprises 1130 completed mergers and acquisitions in the Chinese takeover market reported in the Securities Data Corporation (SDC) from 2010 to 2018. We define bidders or targets with lower reputational risk if their scores provided by RepRisk database are below the median value and vice versa. The bidder and target belong to the existing market if they share the same Fama-French 48 industrial category. Leverage is defined as long-term debt scaled by total assets, firm size is log of book value of total assets, profitability is ratio of earnings before interest and tax to employed capital, sales growth is percentage change in sales from previous to following year, cash flows is computed as operational cash flows minus capital expenditures scaled by total assets, tangibles are calculated as adjusted common stockholder (i.e., equity minus intangible assets) divided by adjusted total assets (total assets minus intangible assets), target status is a binary variable with value of one if target is publicly listed firm and zero otherwise, payment method is a binary variable with value of one for the deals paid in cash and zero otherwise, GDP growth is yearly real GDP growth, and GDP per capita is the natural logarithm of real GDP. All regression models use year and industry fixed effects. *, **, and *** show statistical significance at 10%, 5%, and 1% level, respectively. In parentheses are *t*-statistics and the White (1980) robust standard errors are used for heteroscedasticity. * $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$.

made by bidders in existing and new markets. Considering our second hypothesis (H2), we propose that bidders with lower reputational risk earn positive returns in both markets while bidders with higher reputational risk face significant losses in existing market and generate higher returns in new market. Such market reactions appear due to bargaining power of bidders with lower reputational risk that translates into lower takeover premia. Therefore, we estimate Equation (2) to test H2, and results from cross-sectional regressions are reported in Table 6.

The results from Models (1) and (2) of Panel A show that bidders with lower (higher) reputational risk earn significantly positive (negative) returns in the full sample of M&As.⁹ The results are qualitatively similar in the existing market as shown in Models (3) and (4). In Models (5) and (6), we find that bidders earn higher returns when entering into the new market regardless of the level of reputational risk. We further re-estimate Equation (2) using takeover premium as the dependent variable. To measure takeover premium, we used ratio of bidder's deal offer price to the target's stock price 1 week before the announcement of M&A deal, supplied by SDC database. The results from Models (7) to (12) show that bidders with lower reputational risk pay fairer premium in the full sample and in both markets (existing and new). However, bidders with higher reputational risk before the deal announcement pay higher premium in the full sample and when entering into the new market.

Our results on announcement returns and takeover premium suggest that the bidder's selection of target is positively or negatively reacted by the stock market both in the existing or new market. These results are aligned with earlier studies on reputational risk in M&As (Laamanen, 2007; Maung et al., 2020; Reuer et al., 2012), bidder returns and takeover premium (Bose et al., 2021; Hussain et al., 2022; Hussain & Loureiro, 2023; Wang & Xie, 2009). More importantly, our results extend the work of Maung et al. (2020) and show that the bidders' reputational risk also affects takeover premium in the domestic M&As and bidders with lower reputational risk have better bargaining power to pay a fair price to targets.

Our results on bidder returns show that bidder managers do not care about stock market reaction.¹⁰ For instance, we find that deals of high to high reputational risk are completed even in the presence of a negative stock market reaction. More importantly, the economic effect is higher for high-to-high deals than low-to-low deals in full sample and in the existing market. Since bidder managers do not prioritize negative stock market reactions, there is potential that deals between high to high firms show negative form operating performance. To test this conjecture, we re-estimated Model (3) by replacing returns with operating

performance. We used industry-adjusted return on assets (ROA) and industry-adjusted return on equity (ROE) as proxies of operating performance. The results reported in Panel B of Table 6 corroborate our conjecture that high-to-high deals continue to perform poorly.

5.3 | Bidder reputational risk and time taken for deal completion

We further provide insight to the role of reputational risk in the Chinese takeover market by examining how bidder reputational risk affects time taken to complete the deal. We propose that deal completion time must be lower if the stock market positively reacts to deals by bidders with lower reputational risk and encourages M&A deals of similar resources. According, we re-estimate Equation (1) by replacing target reputational risk with time of deal completion.

In Models (1) and (2), we find that bidders with lower (higher) reputational risk acquiring targets with lower reputational risk take few days (almost 3 days earlier) to complete the deal while bidders with higher reputational risk acquiring targets with higher reputational risk take more days. This reported pattern is also observed in the existing market as shown in Models (3) and (4). In Models (5) and (6), we show that bidders with lower/higher reputational risk take lesser days to complete the deal. The results suggest that bidders are more efficient to enter in the new markets than domestic markets regardless of the level of reputational risk. The findings add to the study of Hussain and Shams (2022) and suggest that besides better CSR, firm reputational risk also determines efficiency of deal completion (Table 7).

6 | ROBUSTNESS TESTS

We examine the robustness of the impact of reputational risk on target selection, announcement returns, and takeover premium documented above and report results in Table 8.

First, we use tercile and quintile distributions of reputational risk and show results in Panel A of Table 8. The bidders/targets are considered having lower reputational risk if the reputational risk is lying in the 1st tercile or 1st quintile, while bidders/targets are defined as having higher reputational risk if their respective scores are lying in the 3rd or 5th quintile. The results are similar to the previous analysis and exhibit that bidders select targets with similar level of reputational risk both in full sample

TABLE 7 Days to complete the deal.

	Dependent variable: Natural logarithm of days to complete the deal					
	Full sample		Existing market		New market	
	(1) Low to low	(2) High to high	(3) Low to low	(4) High to high	(5) Low to high	(6) High to low
<i>Reputational risk</i>	-2.609*** (-31.752)	2.462*** (30.166)	-2.850*** (-34.319)	2.287*** (25.005)	-1.679*** (-7.534)	-1.556*** (-5.902)
<i>Bidder leverage</i>	1.453*** (2.664)	0.798 (1.528)	2.151*** (4.079)	1.191* (1.944)	-1.395 (-1.152)	-3.823* (-1.772)
<i>Bidder firm size</i>	-0.157*** (-4.057)	-0.180*** (-4.335)	-0.168*** (-4.862)	-0.202*** (-4.634)	-0.063 (-0.403)	0.089 (0.507)
<i>Bidder Profitability</i>	-1.427 (-1.360)	-0.331 (-0.316)	1.025 (0.986)	0.880 (0.716)	-8.280** (-2.266)	-6.742 (-1.435)
<i>Bidder sales growth</i>	-0.131*** (-2.902)	-0.167*** (-4.023)	-0.099** (-2.235)	-0.167*** (-3.188)	-0.387** (-2.362)	-0.447** (-1.988)
<i>Bidder cashflows</i>	-0.419 (-1.048)	-0.477 (-1.034)	0.448 (1.141)	0.134 (0.274)	-2.532 (-1.207)	-9.065*** (-2.992)
<i>Bidder tangibles</i>	-0.076 (-0.235)	-0.068 (-0.195)	-0.437 (-1.397)	-0.112 (-0.270)	1.032 (1.495)	0.907 (0.549)
<i>Target status</i>	-0.151 (-1.338)	-0.253** (-2.241)	0.131 (1.202)	-0.019 (-0.139)	-0.915*** (-3.340)	-1.253*** (-4.056)
<i>Payment method</i>	-0.035 (-0.352)	-0.156 (-1.568)	0.098 (1.040)	-0.235** (-2.038)	-1.114*** (-4.489)	-1.023*** (-3.733)
<i>GDP growth</i>	0.827** (2.285)	1.029*** (3.100)	1.493*** (5.038)	1.366*** (4.014)	-0.884 (-0.802)	-1.037 (-1.001)
<i>GDP per capita</i>	0.000 (1.621)	0.001** (2.342)	0.001*** (4.357)	0.001*** (3.400)	-0.001 (-0.879)	-0.001 (-0.873)
Constant	-2.462 (-0.491)	-6.737 (-1.456)	-12.229*** (-3.005)	-11.615** (-2.438)	19.689 (1.258)	18.879 (1.308)
Year & industry FE	Yes	Yes	Yes	Yes	Yes	Yes
N	1065	1065	869	869	196	196
Adjusted R ²	0.552	0.519	0.678	0.502	0.338	0.504

Note: The table shows results for the effect of bidders' reputational risk on the log days (natural logarithm of the difference between the day of announcement and the day of deal completion). The sample comprises completed mergers and acquisitions in the Chinese takeover market reported in the Securities Data Corporation (SDC) from 2010 to 2018. We define bidders or targets with lower reputational risk if their scores provided by RepRisk database are below the median value and vice versa. Leverage is defined as long-term debt scaled by total assets, firm size is log of book value of total assets, profitability is ratio of earnings before interest and tax to employed capital, sales growth is percentage change in sales from previous to following year, cash flows is computed as operational cash flows minus capital expenditures scaled by total assets, tangibles are calculated as adjusted common stockholder (i.e., equity minus intangible assets) divided by adjusted total assets (total assets minus intangible assets), target status is a binary variable with value of one if target is publicly listed firm and zero otherwise, payment method is a binary variable with value of one for the deals paid in cash and zero otherwise, GDP growth is yearly real GDP growth, and GDP per capita is the natural logarithm of real GDP. All models use year and industry fixed effects. *, **, and *** show statistical significance at 10%, 5%, and 1% level, respectively. In parentheses are *t*-statistics and the White (1980) robust standard errors are used for heteroscedasticity. * $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$.

and existing market while bidders with lower (higher) reputational risk select targets with higher (lower) reputational risk in the new market.

Second, year 2015 and real estate industry dominate our sample and to make sure that our baseline results are

not driven by top year and industry, we exclude deals from 2015 and real estate industry in separate regressions and re-estimate Equation (1). Models (1) to (6) of Table 8 show that even after excluding top year our findings still hold that ensures validity of results documented before.

TABLE 8 Robustness tests.

Panel A: Alternative thresholds for reputational risk																	
Tercile																	
Quintile																	
Full sample			Existing market			New market			Full sample			Existing market			New market		
(1) Low to low	(2) High to high	(3) Low to low	(4) High to high	(5) Low to high	(6) High to low	(7) Low to low	(8) High to high	(9) Low to low	(10) High to high	(11) Low to high	(12) High to low						
<i>Reputational risk</i>																	
1.247***	0.991***	1.287***	1.020***	1.496***	0.608***	1.166***	0.867***	1.192***	0.935***	1.490***	0.457*						
(13.904)	(10.771)	(12.968)	(10.575)	(5.993)	(2.896)	(11.343)	(7.844)	(10.520)	(8.030)	(5.066)	(1.783)						
Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes						
Year & industry FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes						
Constant	-15.740***	7.537	-15.746***	5.321	-9.801	14.500	-14.265***	1.703	-15.678**	-2.586	-9.447	-0.418					
	(-3.177)	(1.621)	(-2.670)	(1.036)	(-0.948)	(1.483)	(-2.654)	(0.332)	(-2.413)	(-0.444)	(-0.892)	(-0.108)					
N	1130	1130	921	921	209	209	1130	1130	921	921	209	209					
Pseudo R ²	0.1742	0.1416	0.1892	0.1278	0.2310	0.1104	0.1517	0.1215	0.1660	0.1097	0.2119	0.1073					
Panel B: Excluding top year and industry																	
Excluding 2015																	
Excluding real estate industry																	
Full sample			Existing market			New market			Full sample			Existing market			New market		
(1) Low to low	(2) High to high	(3) Low to low	(4) High to high	(5) Low to high	(6) High to low	(7) Low to low	(8) High to high	(9) Low to low	(10) High to high	(11) Low to high	(12) High to low						
<i>Reputational risk</i>																	
0.777***	1.953***	1.113***	2.617***	1.168***	1.250***	0.760***	1.915***	1.099***	2.513***	1.142***	1.085***						
(8.168)	(16.484)	(10.669)	(14.830)	(4.007)	(5.041)	(8.506)	(17.578)	(11.155)	(16.173)	(4.398)	(5.080)						
Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes						
Year & industry FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes						
Constant	-8.378*	8.245	-8.196	7.470	11.856	19.307*	9.266*	-8.628	9.142	10.031	16.266						
	(-1.830)	(1.546)	(-1.595)	(1.177)	(1.182)	(1.820)	(1.711)	(-1.591)	(1.403)	(1.024)	(1.602)						
N	892	892	730	730	173	173	1017	809	809	208	208						
Pseudo R ²	0.1007	0.3266	0.1394	0.4230	0.2028	0.1040	0.3255	0.4148	0.1818	0.2031	0.1807						

(Continues)

TABLE 8 (Continued)

Panel C: Alternative measure of returns and takeover premium

	Takeover premium											
	Bidder returns				New market				Existing market			
	Full sample		Existing market		New market		Full sample		Existing market		New market	
	(1) Low to low	(2) High to high	(3) Low to low	(4) High to high	(5) Low to high	(6) High to low	(7) Low to low	(8) High to high	(9) Low to low	(10) High to high	(11) Low to high	(12) High to low
<i>Reputational risk</i>	0.028*** (4.960)	-0.027*** (-4.737)	0.035*** (5.415)	-0.023*** (-3.380)	0.020* (1.708)	0.017* (1.708)	-0.011*** (-4.825)	0.009*** (4.121)	-0.013*** (-5.089)	0.008*** (2.936)	-0.009* (-1.846)	-0.010** (-2.155)
Control variables	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year & industry FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Constant	0.318 (1.508)	0.362* (1.717)	0.305 (1.100)	0.305 (1.112)	-0.029 (-0.127)	-0.088 (-0.284)	-0.172** (-2.000)	-0.188** (-2.203)	-0.155 (-1.414)	-0.155 (-1.424)	-0.098 (-0.577)	-0.082 (-0.394)
<i>N</i>	1130	1130	921	921	209	209	1130	1130	921	921	209	209
Adjusted <i>R</i> ²	0.186	0.185	0.197	0.180	0.140	0.373	0.194	0.189	0.213	0.198	0.159	0.352

Note: The table presents results for the likelihood of bidders with lower/higher reputational risk to acquire targets with lower/higher reputational risk. We define bidders or targets with lower reputational risk if their scores provided by RepRisk database belong to the lower tercile or quintile distributions and vice versa (Panel A). The sample comprises 1130 completed mergers and acquisitions in the Chinese takeover market reported in the Securities Data Corporation (SDC) from 2010 to 2018. The bidder and target belong to the existing market if they share the same Fama-French 48 industrial category. Control variables are the same as in our baseline models. All probit models use year and industry fixed effects. *, **, and *** show statistical significance at 10%, 5%, and 1% level, respectively. In parentheses are *t*-statistics and the White (1980) robust standard errors are used for heteroscedasticity. **p* < 0.1; ***p* < 0.05; ****p* < 0.01.

TABLE 9 Endogeneity – propensity score matching (PSM).

Panel A: Difference in means between high and low reputational risk						
Variables	High reputational risk (Mean)	Low reputational risk (Mean)	Difference	p-value		
<i>Bidder leverage</i>	0.132	0.157	-0.025***	0.001		
<i>Bidder firm size</i>	2.154	1.032	1.122	0.482		
<i>Bidder profitability</i>	0.315	0.309	0.006*	0.070		
<i>Bidder sales growth</i>	0.002	0.035	-0.033***	0.024		
<i>Bidder cash flows</i>	0.642	0.538	0.104*	0.067		
<i>Bidder tangibles</i>	0.246	0.212	0.034***	0.004		
<i>Target status</i>	0.648	0.361	0.287	0.317		
<i>Payment method</i>	0.603	0.587	0.016***	0.002		
<i>GDP growth</i>	5.921	5.016	0.905	0.548		
<i>GDP per capita</i>	7.916	8.148	-0.232	0.324		
Panel B: First stage logit model						
Variables	High reputational risk					
<i>Reputational risk</i>	—					
<i>Bidder leverage</i>	0.254**					
<i>Bidder firm size</i>	0.137					
Other controls	Yes					
Year, industry, and country FE	Yes					
Constant	Yes					
N	1130					
Pseudo R ²	0.125					
Panel C: Regressions for treatment group						
	Likelihood to acquire		Bidder returns			
	Full sample	Existing market	New market	Full sample	Existing market	New market
<i>Reputational risk</i>	(1) Low to low	(3) Low to low	(5) Low to high	(7) Low to low	(9) Low to low	(11) Low to high
	(2) High to high	(4) High to high	(6) High to low	(8) High to high	(10) High to high	(12) High to low
Control variables	0.707*** (6.185)	1.076*** (8.566)	1.346*** (3.503)	0.020*** (3.257)	0.026*** (3.736)	0.016 (1.251)
	Yes	Yes	Yes	Yes	Yes	Yes
	Yes	Yes	Yes	Yes	Yes	Yes
	1.895*** (13.821)	2.866*** (9.662)	1.388*** (5.748)	-0.021*** (-3.976)	-0.022*** (-3.014)	0.013 (1.018)

(Continues)

TABLE 9 (Continued)

		Bidder returns													
		Likelihood to acquire				New market				Existing market				New market	
		Full sample		Existing market		New market		Full sample		Existing market		New market			
		(1) Low to low	(2) High to high	(3) Low to low	(4) High to high	(5) Low to high	(6) High to low	(7) Low to low	(8) High to high	(9) Low to low	(10) High to high	(11) Low to high	(12) High to low		
Year & industry FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes		
Constant	–6.373 (–1.146)	6.215 (1.003)	–7.737 (–1.164)	4.532 (0.620)	–12.940 (–0.572)	–0.288 (–0.012)	0.136 (0.627)	0.181 (0.846)	–0.099 (–0.321)	–0.087 (–0.280)	0.208 (0.692)	0.099 (0.236)			
N	792	792	616	616	176	176	794	794	616	616	178	178			
Pseudo R ² or Adjusted R ²	0.0985	0.2850	0.1211	0.3234	0.1771	0.2668	0.267	0.271	0.306	0.298	0.171	0.366			

Note: The table presents results for the likelihood of bidders with lower/higher reputational risk to acquire targets with lower/higher reputational risk and how reputational risk affects bidder returns for the treatment group. Using PSM, we identify treatment group that have similar firm and deal characteristics as the control group. We define bidders or targets with lower reputational risk if their scores provided by RepRisk database are below the median value and vice versa. The sample consists 1130 completed mergers and acquisitions in the Chinese takeover market reported in the Securities Data Corporation (SDC) from 2010 to 2018. The bidder and target belong to the existing market if they share the same Fama–French 48 industrial category. Control variables are the same as in the baseline models. All models use year and industry fixed effects. *, **, and *** show statistical significance at 10%, 5%, and 1% level, respectively. In parentheses are *t*-statistics and the White (1980) robust standard errors are used for heteroscedasticity. All variables are defined in Appendix A. * $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$.

Similarly, findings remain consistent when we drop deals from real estate industry, shown in Models (7) to (12).

Third, we use alternative measures of bidder CARs and takeover premium: 5-day CARs and the ratio of bidders offer price to target's stock price 4 weeks before the deal announcement. Our results are qualitatively similar to what we documented in Table (7), providing evidence that our results are not confined to measures of returns and takeover premium.

Finally, we remit prospective concerns that our findings may affect potential endogeneity emerging from sample selection bias. It may happen that firms with certain characteristics that affect target selection may also be disposed to targets with higher reputational risk, thus what we ascribe to reputational risk may be driven by other aspects. Similarly, scholars are exposed to limited information compared to market participants and managers which can also cause a self-selection bias due to unobservable differences (factors that affect treatment outcome and selection process) which they fail to control (Tucker, 2010). For instance, any specific corporate information related to reputational risk revealed to market participants only because of audit but may be too costly for scholars to gather it, can be considered as an example of unobservable differences. This effect is more prominent when ex-post analysis of corporate decisions is carried out, firms are heterogeneous, and a potential self-selection process exists. Thus, failure to control for these unobservable differences causes sample selection bias that may lead to potential endogeneity problems resulting in distorted and biased estimations (Li, 2013; Yang et al., 2012). Last but not least, potential endogeneity can also arise due to omitted variable bias, such as organizational culture, that again yields biased estimations (Li, 2013; Zhang et al., 2022).

To address this issue, we followed Chang et al. (2013), Yang et al. (2012), and Boubaker et al. (2016) and generated two comparable samples of treatment and control group using the Propensity Score Matching (PSM) technique as it tackles the potential endogeneity problem efficiently by differentiating the treatment effect of reputational risk (Chang et al., 2013). Chang et al. (2013) and Titus (2007) argue that in the case of sample selection bias, PSM is an appropriate technique to adjust for sample selection bias and eliminate the potential endogeneity problem as it creates a quasi-control group for the matching. Moreover, Zhang et al. (2022) assert that employing PSM is apt in addressing endogeneity, especially when it arises due to omitted variable bias. This is because omitted variables can impact the distribution of groups in the sample, making PSM a superior technique as it leverages propensity scores (occurrence probability)

to simulate randomly matched sets in the sample (Nekhili et al., 2018).

Using sample median as a cut-off, we first divide our takeover sample into two groups of low and high reputational risk and used one-to-one matching with calliper distance of 0.01 and identify pairs of comparable M&A deals from two groups of low and high reputational risk. Panel A of Table 9 reports the disparity in mean values of all variables employed as covariates in the matching procedure for subsamples of low and high takeover competition. In Panel B, we show results for the logit model employing same control variables as in our baseline models (Table 4). In Panel C (Models 1 to 12), we re-estimate Equation (1) and (3) using the matched sample and find similar results uncovered before.

7 | DISCUSSION AND CONCLUSIONS

7.1 | Summary

We examine the effect of reputational risk on target selection and how stock market reacts to bidders' choices using sample of the Chinese M&As from 2010 to 2018. We find evidence that bidders with lower reputational risk before the deal announcement select targets with lower reputational risk and this pattern of target selection also holds in the existing market. These results suggest that bidders really care about similarity in intangible resources when engage in M&A especially acquiring targets from the similar industry. We attribute these findings to the importance of resources similarity in M&As (Boone & Uysal, 2020; Halebian et al., 2017). However, bidders with lower (higher) pre-deal reputational risk select targets with higher (lower) reputational risk when entering into the new market, suggesting that bidders preferences vary if entering into the new market and they see differences in resources as a way transferring better reputational resources from one firm to another (i.e., from the bidder to target or from the target to bidder). Our results on reported patterns verify the bidders' motives of resource deployment or acquisition depending on the market they enter and target selection patterns are more pronounced if targets are privately owned firms. Moreover, we find that higher target firm growth and the larger target size are more relevant in the existing market.

We also show that stock market positively reacts to acquisitions by bidders with lower reputational risk in full sample and existing market while negatively reacts to takeovers of bidders with higher reputational risk in full

sample and existing market. However, stock market always positively react to acquisitions by bidders entering into the new market and acquiring targets with different levels of reputational risk. It can be argued that shareholders of bidder firms believe in value-creation in deals with varying levels of reputational risk between merging firms. We further find that reported association between bidder returns and reputational risk is partly explained by bargaining power of bidders but only in the existing market – bidders with lower reputational risk pay fair premium to win the auction. Takeover premiums in the new market are unaffected by the level reputational risk of the bidder firm. Our results are robust to alternative thresholds of reputational risk, different measures of returns and premium, subsamples, and hold after controlling for sample selection bias.

7.2 | Contributions

We contribute to the M&A literature on similarity in firm resources (Bereskin et al., 2018; Brielmaier & Friesl, 2023; Pan & Zhang, 2024) and identify that reputational risk is an important firm resource that bidder managers consider selecting the target. The preferences of bidder managers differ depending on the market they are entering – existing or new market. We extend the target selection literature (Bettinazzi et al., 2020; Kaul & Wu, 2016; Wu & Reuer, 2021) by simultaneously considering the level of reputational risk and the type of target market. We also add to the literature on announcement returns and takeover premium (Bose et al., 2021; Hussain et al., 2022; Wang & Xie, 2009) and suggest that the level of reputational risk of combining firms partly explains returns and premium. Notably, our findings extend the work of Maung et al. (2020) and document that the bidders' varying reputational risk also affects takeover premium in the domestic M&As instead of cross-border deals. Finally, we contribute to the studies talking about pre-deal differences in M&As (Ellis et al., 2017; Martynova & Renneboog, 2008; Yan & Zhang, 2003). We show that bidders entering into the new markets select targets with different levels of reputational risk, proposing that portability or learning of better reputational practices is the motive behind such target selections.

7.3 | Implications for managers and investors

Our study offers implications for bidder managers and policymakers. As bidders with lower reputational risk perform well in the Chinese takeover market so bidder

managers must consider reputational risk as a business strategy and develop reputation to attain a competitive advantage in the takeover market. Bidder managers also need proper evaluation of targets through due diligence in order to achieve takeover synergies. Understanding the expectations and concerns of stakeholders, managers should involve all stakeholders in the decision-making. They also need to use corporate values such as reputational risk for evaluating target firms and ensuring that targets' reputational and ethical standards are well-aligned with their firms. In case of complex reputational risk assessment, bidder managers should consult with external experts to realize takeover benefits.

Investors must be aware of the probable risks of being expropriated if bidders acquire firms with different levels of reputational risks, particularly if the bidders and targets are from the same industry. They can use deals by risky bidders as signals for value destruction (creation) in the existing (new) market. Additionally, investors must stay informed regarding industry regulations that may affect stock price reactions around the deal announcement. Although researchers add firm-fixed effects in multivariate analysis, it is pertinent to investigate how certain firm-related attributes, such as reputational risk, affect investors' wealth.

7.4 | Limitations and future research

Our work is subject to certain limitations that welcome future work in the domain of reputational risk. First, we used secondary data that did not permit us to get stock price data and accounting information of private target firms. Although, publicly available information has more transparency and offers detailed and accurate insights as highlighted by Capron and Shen (2007) in the case of merger and acquisitions and target selection process. However, further work can explore how acquisition choices are affected by varying levels of reputational risk of combining firms if the bidder and target are privately owned firms as suggested by Welch et al. (2020) and Capron and Shen (2007).

Second, our conclusions are drawn from M&As and we cannot generalize our findings to other restructuring activities such as strategic alliances and joint ventures as we contributed to target selection literature (Kaul & Wu, 2016). Future studies can examine the role of reputational risk in other restructuring activities and its effect on key stakeholders.

Third, we consider domestic deals using the sample period of 9 years in the Chinese takeover market to examine the effect of the bidder's reputational risk in the target selection and recommend expanding work to

cross-border takeovers and a larger sample period for generalizing our findings as Lodh et al. (2024) and Zahoor et al. (2022) highlighted the need of deeper understanding of the pivotal role of reputational risk in cross-border M&As along with domestic M&As and bidders-target's learning capacity. Finally, we examined the consequences of reputational risk without paying attention to antecedents and scholars should investigate what determines the level of reputational risk, what is firm's attitude towards reputational risk, and to what extent firms tolerate the reputational risk or take actions to reduce it as highlighted by Lodh et al. (2024) to better understand the role of reputational risk in the takeover market.

ACKNOWLEDGEMENTS

We acknowledge constructive comments from the associate editor and three anonymous reviewers.

CONFLICT OF INTEREST STATEMENT

The authors declare no conflicts of interest.

DATA AVAILABILITY STATEMENT

The data that support the findings of this study are available on request from the corresponding author. The data are not publicly available due to privacy or ethical restrictions.

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ENDNOTES

- ¹ It is a prospective impairment that may be caused to a firm's reputation as a consequence of its actions including legal violations, ethical lapses, and negative publicity (Rindova et al., 2006; Zhou & Wang, 2020), among others.
- ² A firm's reputation is important in M&As because acquiring a firm with lower reputation will damage the acquirer's reputation (Fong et al., 2013).
- ³ Larsson and Finkelstein (1999) illustrate integration as 'the degree of interaction and coordination of the two firms involved in a merger or acquisition'.
- ⁴ For instance, a bidder's lower pre-deal reputational risk than the target can be learnt by the latter to improve its image as a well-reputed firm. Similarly, if the target firm has a lower reputational risk than the bidder before the deal announcement, it can create an opportunity for the bidder to enhance its reputation.
- ⁵ We select this period due to convenience in data availability of reputational risk of combining firms.
- ⁶ In our robustness tests, we also used tercile and quintile distributions to define bidders or targets with lower (higher) reputational risk when their reputational risk scores belong to the lowest (highest) terciles or quintiles.

⁷ If the reputational risk scores of the bidder or target is in the lowest tercile or quintile, we call it a firm with lower reputational risk and vice versa.

⁸ Martynova and Renneboog (2008) and Jensen and Ruback (1983) discuss the determinants of M&As and their wealth impacts.

⁹ Our results also hold when we consider difference between the bidder and target reputational risk.

¹⁰ We are thankful to the anonymous reviewer for drawing our attention to this point.

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SUPPORTING INFORMATION

Additional supporting information can be found online in the Supporting Information section at the end of this article.

How to cite this article: Hussain, T., Saeed, A., & Riaz, H. (2024). Reputational risk and target selection: An evidence from China. *International Journal of Finance & Economics*, 1–29. <https://doi.org/10.1002/ijfe.3030>

APPENDIX A: VARIABLE DEFINITIONS

Variable	Definition
Panel A: Reputational risk	
<i>Reputational risk</i>	Scores on reputational risk. Source: RepRisk
Panel B: Existing and new markets	
<i>Existing market</i>	Both bidder and target are from the same Fama-French 48 industries.
<i>New market</i>	Bidder and target are from different Fama-French 48 industries.
Panel C: Returns and takeover Premium	
<i>Bidder returns</i>	3-day or 5-day cumulative abnormal returns around the deal announcement. The returns are computed using the market model for the estimation window of 255 to 25 days before the deal announcement. Source: DataStream.
<i>Takeover premium</i>	The ratio of bidder's offer price to the target's stock price 1 week before the deal announcement. Source: Securities Data Corporation (SDC).
Panel D: Bidder characteristics	
<i>Leverage</i>	Long-term debt scaled by total assets. Source: WorldScope.
<i>Firm size</i>	Log of book value of total assets. Source: WorldScope.
<i>Profitability</i>	Ratio of earnings before interest and tax to employed capital. Source: WorldScope.
<i>Sales growth</i>	Percentage change in sales from previous to following year. Source: WorldScope.
<i>Cash flows</i>	(Operational cash flows – capital expenditures)/total assets. Source: WorldScope.
<i>Tangibles</i>	(Common stockholder equity – intangible assets)/(total assets – intangible assets)
Panel E: Deal characteristics	
<i>Payment method</i>	Binary variable: 1 for the deals paid with cash and 0 otherwise. Source: SDC.
<i>Target status</i>	Binary variable: 1 if target is publicly listed firm and 0 otherwise. Source: SDC.
Panel F: Country characteristics	
<i>GDP growth</i>	Yearly real GDP growth. Source: World Development Indicators (WDI).
<i>Log GDP per capita</i>	Natural logarithm of real GDP. Source: WDI.

APPENDIX B: DATA CLEANING STEPS

This table shows each step to be followed to reach the final sample of mergers and acquisitions in the Chinese takeover market.

Steps	Database	Filters	Number of deals excluded	Number of deals available
1	SDC	Domestic deals from 2010 to 2018 where bidder are publicly listed firms and targets can be publicly listed or private	N/A	1875
2	SDC	Dropping deals from financials and utilities	150	1725
3	RepRisk, WorldScope, DataStream, and World Bank	Eliminating deals with missing observations on variables of interests	595	1130