

**ACQUIRER PERFORMANCE AND ITS
DETERMINANTS: TESTING CROSS-BORDER M&A
IN ASIA**

XIAO WEI YUN
(M.S.c NUS)

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SUMMARY

This thesis investigates two research questions: 1) whether acquiring firms win or lose in the cross-border M&As in Asia; and 2) what are the factors that influence acquirer performance.

Answering the call for understanding the performance of M&As undertaken outside U.S. or Europe, I use the standard event-study approach to examine stock returns to those acquiring firms taking over Asian targets. Further, to explore the factors influencing acquirer performance, I adopt the following underlying logic. Performance of M&As on the stock market depends upon market's valuation of the net present value (NPV) of M&A transactions. As the NPV of an M&A is decided by two parts, value created by the transaction and the cost of this investment, I transform the research question into identifying the factors that influence the realization of value creation and the factors that determine the investment cost of an M&A transaction.

In M&As, value creation is a process which involves combining and making optimal use of two merging firms' specialized resources (technology, production, marketing, finance, human resource, etc.). Therefore, I expect that the achievement of value creation is highly related to two factors: 1) resources that are productive and transferable within the M&A; and 2) the conditions for combination and reconfiguration of such resources. Accordingly, I predict that stock market performance of the acquiring firm in an M&A would be influenced by acquirer's ownership advantages, business relatedness between acquiring and target firm, and

the interaction between business relatedness and ownership advantages.

Cost of M&A is the other side of the coin. An M&A investment can be considered as a process involving searching and valuing targets, negotiation, execution and integration; accordingly, I break the cost of such investment into three parts: searching and valuing cost, negotiation cost and premium paid, and integration cost. I expect that liabilities of foreignness increase M&A cost, while prior M&A experience could help the acquiring firms to save the time, effort, money, or other resources involved in M&A activities, which in turn reduces the M&A cost.

I test my five hypotheses by using a sample of 314 cross-border acquisitions undertaken during 1985-1999, 57% of which was conducted during 1997-1999. These 314 international transactions were made by 246 acquiring firms from the U.S., Hong Kong and Singapore. The U.S. firms seem to be the most active acquirer in my sample; more than half (60.83%) of the transactions were conducted by firms from the United States. On the target side, the 314 transactions cover 11 Asian countries, of which China, Hong Kong, Malaysia, and Singapore had aggregately received 69.11% of the total investment. Further, the data also indicates that Hong Kong, China and South Korea are the most popular destinations for FDI in the sectors of electronic equipment, chemical, printing and etc. U.S. acquirers appear to be more interested in conducting related M&As than their Asian counterparts.

The Patell Z tests in this study show that on average, acquirers earn insignificant abnormal returns from cross-border M&As in Asia. Z Tests on the subsamples of acquirers from different origins find that only the shareholders of U.S. acquiring firms

enjoy significant, but small positive excess returns from the acquisition; but no significant abnormal returns are found among Asian acquirers.

The results for OLS regressions support part of the hypotheses. Specifically, acquiring firms with superior intangible assets would enjoy better performance; related M&As could generate more benefits than unrelated M&As for acquirers; and there exists a significant U-shape relationship between acquirer performance and acquisition experience. On the other hand, the positive effect of intangible assets on acquirer performance seems to be weakened in related M&As. In addition, the study does not find a significant relationship between acquirer performance and acquirer's knowledge of the target.

Combining the empirical results with theoretical arguments, I discuss explanations for the unexpected findings and interpretations for the supported results. Potential improvement in both theoretical and empirical aspects is also addressed.

Table 2-1 Selected Results for Outcome Studies

Study	Time Period	Context	Sample	Acquirer Performance
Meeks (1977)	1964-1972	U.K.	233 acquiring firms	Loss in ROA
Hoshino (1982)	1967-1973	Japan	90 acquisitions	Loss in net profit/assets
Mueller (1986)	1950-1972	U.S.	551 manufacturing firms	Loss in market share and rate of ROE
Ravenscraft & Scherer (1987)	1950-1977	U.S.	456 acquiring firms	Loss in pre-tax ROA
Lang et al. (1989)	1968-1986	U.S.	87 tender offers	Tobin's q: -12%
Cosh et al. (1989)	1981-1983	U.K.	59 acquisitions	Loss in ROA; slow growth

Table 2-2 Selected Results for Event Studies

Study	Time Period	Sample	Event Window	Acquirer Performance
Asquith (1983)	1962-1976	196 acquiring firms	(d= -1,0)	0.20%
Asquith et al. (1983)	1963-1979	214 merger bids	(d= -20, 0)	2.8% *
Bradley et al. (1988)	1963-1968	53 tender offers	(d= -5,+5)	4.09% *
Loughran & Vijh (1997)	1970-1989	405 stock financed acq.	(y=+1, +5)	- 24.2% *
Megginson et al. (2000)	1977-1996	204 acquisitions	(y=+1, +3)	- 13% *

* significant at 10%

Table 2-3 Selected Results for Event Studies on Asia Countries

Study	Time Period	Sample	Event Window	Acquirer Performance
Ding et al. (1996)	1975-1995	23 acquiring firms	(d=-5, 0)	0.66%
Lee et al. (1997)	1983-1992	39 takeovers	(y=-1,+1)	30% *
Pangarkar and Junius (2004)	1990-1999	115 acquisitions	(d=-9, +1)	2.1% *

* significant at 10%

Table 3-1 Benefits, Resources, and Different Types of M&As

	Related M&As	Unrelated M&As
Potential Benefits	Market Power; Economies of Scale / Scope	Internal Capital Market; Diversification of Risk
Transferable Resources	Production Resources; Technological Know-how; Marketing Know-how; Management Know-how;	Financial Resources; Management Know-how;
Organizational changes needed for achieving potential benefits?	More	Less

Table 4-1 Crosstab by SIC and target nation – Entire Sample

SIC_2dig	CH	HK	IDN	MAC	MA	PH	SG	SK	TW	TH	VT	Total
10 (Metal Mining)	0	0	0	0	1	0	0	0	0	0	0	1
13 (Oil & Gas Extraction)	4	1	2	0	0	0	3	0	0	0	1	11
15 (Building Construction General Contractors And Operative Builders)	0	2	0	0	1	0	0	0	0	0	0	3
16 (Heavy Construction Other Than Building Construction Contractors)	2	0	1	0	0	0	0	0	0	0	0	3
17 (Construction Special Trade Contractors)	1	0	0	0	0	0	0	0	0	0	0	1
20 (Food & Kindred Products)	5	1	2	0	5	0	1	1	1	1	1	18
21 (Tobacco Products)	0	0	1	0	0	0	0	0	0	0	0	1
22 (Textile Mill Products)	1	0	0	0	0	0	0	0	1	0	0	2
23 (Apparel And Other Finished Products Made From Fabrics And Similar Materials)	0	0	0	0	2	1	0	0	0	0	0	3
25 (Furniture & Fixtures)	1	1	0	0	0	0	0	2	0	0	0	4
26 (Paper And Allied Products)	0	1	0	0	1	0	0	1	1	0	0	4
27 (Printing, Publishing, And Allied Industries)	0	8	0	0	0	0	0	0	0	0	0	8
28 (Chemicals And Allied Products)	6	2	2	0	1	0	3	6	2	4	0	26
30 (Rubber And Miscellaneous Plastics Products)	2	0	0	0	1	0	1	0	1	0	0	5
31 (Leather And Leather Products)	1	0	0	0	0	0	0	0	0	0	0	1
32 (Stone, Clay, Glass, And Concrete Products)	1	0	0	0	0	0	0	1	0	0	0	2
33 (Primary Metal Industries)	2	1	0	0	4	0	0	0	0	1	0	8
34 (Fabricated Metal Products, Except Machinery And Transportation Equipment)	0	0	1	0	0	0	1	0	0	0	0	2
35 (Industrial And Commercial Machinery And Computer Equipment)	5	2	0	0	1	0	2	0	3	0	0	13
36 (Electronic And Other Electrical Equipment And Components, Except Computer Equipment)	2	12	0	0	2	0	2	6	3	3	0	30
37 (Transportation Equipment)	3	0	2	0	1	0	1	1	0	0	0	8
38 (Measuring, Analyzing, And Controlling Instruments; Photographic, Medical And Optical Goods; Watches And Clocks)	1	1	0	0	1	0	1	2	1	0	0	7
39 (Miscellaneous Manufacturing Industries)	1	2	0	0	0	0	0	0	0	2	0	5
42 (Motor Freight Transportation And Warehousing)	1	1	0	0	0	0	2	1	0	0	0	5
44 (Water Transportation)	0	0	1	0	1	0	0	0	0	0	0	2
46 (Pipelines, Except Natural Gas)	0	0	0	0	1	0	0	0	0	0	0	1
47 (Transportation Services)	2	2	0	0	0	0	1	1	0	0	0	6
48 (Communications)	2	1	0	0	0	0	0	0	0	0	0	3
49 (Electric, Gas, And Sanitary Services)	3	0	1	0	1	0	1	2	1	0	0	9
50 (Wholesale Trade-durable Goods)	3	9	0	1	6	0	2	0	4	0	0	25
51 (Wholesale Trade-non-durable Goods)	1	0	0	0	1	0	0	0	1	0	0	3
53 (General Merchandise Stores)	1	0	0	0	0	0	0	1	0	0	0	2
55 (Automotive Dealers And Gasoline Service Stations)	1	0	0	0	0	0	0	0	0	0	0	1
58 (Eating And Drinking Places)	0	1	0	0	0	0	0	0	1	0	0	2
59 (Miscellaneous Retail)	0	2	0	0	1	0	1	0	0	0	0	4
60 (Depository Institutions)	0	1	0	0	0	2	0	0	0	0	0	3
61 (Non-depository Credit Institutions)	0	0	0	0	0	0	0	0	0	1	0	1
62 (Security And Commodity Brokers, Dealers, Exchanges, And Services)	0	0	0	0	0	1	0	0	0	2	0	3
63 (Insurance Carriers)	0	1	1	0	0	0	0	0	0	0	0	2
65 (Real Estate)	7	1	1	1	1	1	0	0	0	1	0	13
67 (Holding And Other Investment Offices)	4	2	0	0	3	0	1	0	1	0	0	11
70 (Hotels, Rooming Houses, Camps, And Other Lodging Places)	3	0	0	0	3	1	0	0	0	2	0	9
73 (Business Services)	5	8	0	0	1	1	6	0	4	1	0	26
75 (Automotive Repair, Services, And Parking)	2	0	0	0	0	0	0	0	0	0	0	2
79 (Amusement And Recreation Services)	1	0	0	0	0	0	0	0	0	0	0	1
80 (Health Services)	1	0	0	0	0	1	0	0	0	0	0	2
84 (Museums, Art Galleries, And Botanical And Zoological Gardens)	1	0	0	0	0	0	0	0	0	0	0	1
87 (Engineering, Accounting, Research, Management, And Related Services)	2	4	0	0	0	0	1	1	0	1	0	9
95 (Administration Of Environmental Quality And Housing Programs)	0	0	0	0	1	0	0	0	0	0	0	1
99 (Nonclassifiable Establishments)	1	0	0	0	0	0	0	0	0	0	0	1
Total	79	67	15	2	41	8	30	26	25	19	2	314

Table 4-2 Crosstab by Industry and Target Nation – Hong Kong Acquirer

Industry	CHN	INS	MAC	MAL	PH	TW	TH	TOTAL	(%)
Mineral	1							1	1.61
Construction	2			1				3	4.84
Manufacturing	18	1				1		20	32.26
Transportation, Communication, and Utilities	6							6	9.68
Wholesale Trade				1		1		2	3.23
Retail Trade	1							1	1.61
Finance, Insurance, and Real Estate	9		1	1		1	1	13	20.97
Service Industries	10			1	1	1	2	15	24.19
Public Administration	1							1	1.61
TOTAL	48	1	1	4	1	4	3	62	100
(%)	77.4	1.61	1.61	6.45	1.61	1.61	4.84	100	

Table 4-3 Crosstab by Industry and Target Nation – Singapore Acquirer

Industry	CHN	HK	INS	MAC	MAL	PH	TW	TH	TOTAL	(%)
Mineral	1								1	1.64
Construction	1	2							3	4.92
Manufacturing	3	3	2		12			2	22	36.07
Transportation, Communication, and Utilities	1		1		1				3	4.92
Wholesale Trade	1	1		1	4				7	11.48
Retail Trade	1	2			1		1		5	8.20
Finance, Insurance, and Real Estate	2	3	1		3	2			11	18.03
Service Industries	4	1			3	1			9	14.75
Public Administration									0	0
TOTAL	14	12	4	1	24	3	1	2	61	100
(%)	22.95	19.67	6.56	1.64	39.34	4.92	1.64	3.28	100	

Table 4-4 Crosstab by Industry and Target Nation – Asia Acquirer

Industry	CHN	HK	INS	MAC	MAL	PH	TW	TH	TOTAL	(%)
Mineral	2								2	1.63
Construction	3	2			1				6	4.88
Manufacturing	21	3	3		12		1	2	42	34.15
Transportation, Communication, and Utilities	7		1		1				9	7.32
Wholesale Trade	1	1		1	5		1		9	7.32
Retail Trade	2	2			1		1		6	4.88
Finance, Insurance, and Real Estate	11	3	1	1	4	2	1	1	24	19.51
Service Industries	14	1			4	2	1	2	24	19.51
Public Administration	1								1	0.81
TOTAL	62	12	5	2	28	4	5	5	123	100
(%)	50.41	9.76	4.07	1.63	22.76	3.52	4.07	4.07	100	

Table 4-5 Crosstab by Industry and Target Nation – U.S. Acquirer

Industry	CHN	HK	INS	MA	PH	SG	SK	TW	TH	VT	TTL	(%)
Mineral	2	1	2	1		3				1	10	5.24
Construction			1								1	0.52
Manufacturing	10	28	5	7	1	12	20	12	9	1	105	54.97
Transportation, Communication, and Utilities	1	4	1	2		4	4	1			17	8.90
Wholesale Trade	3	8		2		2		4			19	9.95
Retail Trade		1				1	1				3	1.57
Finance, Insurance, and Real Estate		2	1		2	1			3		9	4.71
Service Industries	1	11			1	7	1	3	2		26	13.61
Public Administration				1							1	0.52
TOTAL	17	55	10	13	4	30	26	20	14	2	191	100
(%)	8.9	28.8	5.24	6.81	2.09	1.57	1.36	10.47	7.33	1.05	100	

Table 4-6 Hypotheses, Key Constructs & Measures for Variables

Hypothesis	Key Construct	Measures
H1	Ownership Advantage -> High Performance	<u>Performance:</u> Cumulative Abnormal Returns <u>Ownership Advantage:</u> Intensity of intangible assets (IA/TA) Intensity of R&D expenses (RD/TA) (US subsample only) Intensity of advertising expenses (ADV/TA) (US subsample only)
H2	Relatedness -> High Performance	REL is coded as 1 when acquirer and target are operating in related sectors based on analysis of the business description of the 4-dig SIC codes, otherwise coded as 0.
H3	Ownership Advantages in related M&As -> High Performance	<u>Interaction factor:</u> $Interaction_1 = (IA/TA) * (REL)$ $Interaction_2 = (RD/TA) * (REL)$ (US subsample only) $Interaction_3 = (ADV/TA) * (REL)$ (US subsample only)
H4	Acquirer's knowledge about -> Low Performance	<u>Knowledge about target:</u> 1) INS_1 coded as 1 if acquirer holds equity shares prior to the M&A, otherwise coded as 0. 2) INS_2 is coded as 1 if the acquirer holds more than 10%, otherwise it is coded as 0.
H5	Prior M&A experience -> High performance	<u>Prior M&A experience:</u> 1) Number of M&As undertaken prior to the focal transaction 2) Squared term of 1) 3) Logarithm of the measure 1) 4) Squared term of 3) 5) length of months between the focal transaction and the first transaction 6) length of years between the focal transaction and the first transaction 7) a dummy coded as 1 if acquirer has undertaken M&A previously, otherwise coded as 0.

Table 4-7 Variable Description – Entire Sample

Measures	Minimum	Maximum	Mean	Standard Deviation
CARs(-20,+1)	-0.5136	1.0404	0.0047	0.1466
OWNERSHIP ADVANTAGE (IA/TA)	0	0.5946	0.0931	0.1122
RELATED	0	1	0.64	0.48
UNRELATED	0	1	0.36	0.48
HORIZONTAL	0	1	0.52	0.50
VERTICAL	0	1	0.12	0.33
SAME BUSINESS	0	1	0.28	0.45
SIMILAR PRODUCTION	0	1	0.20	0.40
SIMILAR CUSTOMER	0	1	0.04	0.184
SIMILAR TECHNOLOGY	0	1	0.01	0.08
BUYING A SUPPLIER	0	1	0.06	0.245
BUYING A BUYER	0	1	0.06	0.239
OWNERSHIP ADVANTAGE *RELATEDNESS	0	0.5946	0.0598	0.0985
KNOWLEDGE ABOUT TGT	0	1	0.14	0.348
EXPERIENCE (ln)	0	2.0794	0.2509	0.4404
EXP_2 (SQUARED TERM)	0	4.3241	0.2563	0.5781
PAYMENT MODE	0	1	0.09	0.29
PRIVATELY NEGOTIATED	0	1	0.02	0.148
SIZE (ln)	1.2986	18.4804	9.6134	3.7523
CASH FLOW	0	0.7208	0.0878	0.1115
LIABILITIES	0	0.9236	0.1394	0.1447
PRE-ACQ PROFITABILITY	-2.053	5.1056	0.0938	0.3899

Table 5-1 Average cumulative abnormal returns and Patell Z scores

	Hong Kong	Singapore	U.S.	Asia	Total
ACARs	-1.29%	0.25%	1.12%	-0.60%	0.48%
Z	-0.16	0.04	1.89*	-0.07	1.17

* significant at 10%

Table 5-2 Entire Sample, Dependent Variable: CARs (-20, +1)

Independent Variable	Model 1		Model 2		Model 3	
	Coefficient	t-ratio	Coefficient	t-ratio	Coefficient	t-ratio
OWNERSHIP ADVANTAGE	0.341	2.594**	0.340	2.582**	0.356	2.701***
RELATED HORIZONTAL	0.038	1.756*				
VERTICAL			0.039	1.760*		
SAME BUSINESS					0.039	1.549
SIMILAR PROD					0.035	1.332
SIMILAR CUSM					0.057	1.131
SIMILAR TECH					0.304	2.673***
BUY SUPPLIER					0.037	0.965
BUY BUYER					0.032	0.778
RELATED*OWNERSHIP ADVANTAGE	-0.501	-3.160***	-0.500	-3.149***	-0.517	-3.238***
KNOWLEDGE OF TGT	-0.024	-0.958	-0.024	-0.951	-0.020	-0.808
EXPERIENCE	-0.109	-2.077**	-0.109	-2.079**	-0.117	-2.220**
SQUARED EXP	0.113	2.880***	0.114	2.883***	0.118	2.953***
PAYMENT	-0.011	-0.359	-0.011	-0.368	-0.019	-0.600
NEGOTIATED	-0.013	-0.212	-0.013	-0.206	-0.004	-0.063
SIZE	-0.005	-1.769*	-0.005	-1.772*	-0.005	-1.607
CASH FLOW	-0.111	-1.333	-0.111	-1.329	-0.122	-1.447
LIABILITIES	0.038	0.600	0.038	0.600	0.040	0.630
PROFITABILITY	0.043	1.900*	0.043	1.889*	0.048	2.103**
YEAR1985	-0.045	-0.448	-0.044	-0.445	-0.064	-0.637
YEAR1986	0.007	0.082	0.006	0.068	-0.010	-0.112
YEAR1987	0.049	0.522	0.048	0.514	0.034	0.365
YEAR1988	-0.245	-2.132**	-0.246	-2.138**	-0.264	-2.289**
YEAR1989	-0.059	-0.652	-0.061	-0.663	-0.084	-0.916
YEAR1990	0.006	0.062	0.006	0.062	-0.010	-0.109
YEAR1991	-0.115	-1.535	-0.115	-1.536	-0.168	-2.163**
YEAR1992	0.058	0.883	0.058	0.884	0.040	0.618

Table 5-2 Entire Sample, Dependent Variable: CARs (-20, +1) – Cont'd

YEAR1993	-0.017	-0.258	-0.017	-0.266	-0.050	-0.764
YEAR1994	-0.023	-0.350	-0.023	-0.349	-0.043	-0.654
YEAR1995	-0.029	-0.478	-0.030	-0.492	-0.050	-0.808
YEAR1996	-0.038	-0.671	-0.039	-0.680	-0.058	-0.998
YEAR1997	0.007	0.129	0.007	0.122	-0.012	-0.209
YEAR1998	-0.012	-0.211	-0.013	-0.221	-0.031	-0.533
YEAR1999	-0.059	-1.011	-0.060	-1.020	-0.077	-1.297
TGT NAT_HK	0.066	1.652*	0.067	1.662*	0.084	2.062**
TGT NAT_MA	0.058	1.372	0.059	1.385	0.075	1.736*
TGT NAT_SG	0.039	0.881	0.040	0.897	0.058	1.278
TGT NAT_CN	0.087	2.129**	0.088	2.136**	0.103	2.478**
TGT NAT_ID	0.108	2.117**	0.109	2.118**	0.109	2.124**
TGT NAT_MC	0.012	0.108	0.012	0.110	0.041	0.315
TGT NAT_PH	0.054	0.844	0.055	0.848	0.070	1.089
TGT NAT_SK	0.027	0.602	0.028	0.614	0.041	0.895
TGT NAT_TW	0.047	1.006	0.048	1.021	0.065	1.385
TGT NAT_VT	-0.018	-0.165	-0.016	-0.144	-0.0001	-0.001
R Square	0.151		0.151		0.169	

* significant at 10% ; ** significant at 5%; *** significant at 1%

Table 5-3 Asia, Dependent Variable: CARs (-20, +1)

Independent Variable	Model 4		Model 5		Model 6	
	Coefficient	t-ratio	Coefficient	t-ratio	Coefficient	t-ratio
OWNERSHIP ADVANTAGE	0.574	1.277	0.566	1.254	0.551	1.185
RELATED	0.079	2.731*				
HORIZONTAL			0.084	2.776***		
VERTICAL			0.054	1.041		
SAME BUSINESS					0.070	1.792*
SIMILAR PROD					0.091	2.176**
SIMILAR CUSM					0.130	1.621
BUY SUPPLIER					0.055	0.991
BUY BUYER					0.045	0.432
RELATED* OWNERSHIP ADVANTAGE	-1.412	-1.413	-1.259	1.214	-1.217	-1.126
KNOWLEDGE OF TGT	0.015	0.367	0.019	0.470	0.022	0.509
EXPERIENCE	-0.112	-1.090	-0.097	-0.915	-0.093	-0.855
SQUARED EXP	0.081	0.914	0.068	0.747	0.067	0.715
PAYMENT	0.003	0.065	0.002	0.035	0.004	0.092

Table 5-3 Asia, Dependent Variable: CARs (-20, +1) – Cont'd

NEGOTIATED	-0.021	-0.235	-0.023	-0.254	-0.017	-0.185
SIZE	-0.006	-0.541	-0.006	-0.578	-0.006	-0.562
CASH FLOW	-0.061	-0.494	-0.061	-0.491	-0.047	-0.358
LIABILITIES	0.107	0.823	0.104	0.795	0.128	0.932
PROFITABILITY	0.056	2.013**	0.056	1.992**	0.055	1.921**
YEAR1989	-0.049	-0.203	-0.061	-0.249	-0.046	-0.183
YEAR1990	-0.167	-0.678	-0.141	-0.559	-0.140	-0.537
YEAR1991	-0.233	-1.176	-0.236	-1.189	-0.231	-1.143
YEAR1992	-0.052	-0.307	-0.052	-0.306	-0.051	-0.296
YEAR1993	-0.044	-0.234	-0.046	-0.246	-0.038	-0.201
YEAR1994	-0.114	-0.624	-0.119	-0.649	-0.121	-0.648
YEAR1995	-0.040	-0.199	-0.042	-0.208	-0.045	-0.218
YEAR1996	-0.057	-0.323	-0.059	-0.331	-0.058	-0.318
YEAR1997	0.002	0.010	0.002	0.009	0.003	-0.015
YEAR1998	-0.074	-0.403	-0.078	-0.422	-0.080	-0.425
YEAR1999	-0.077	-0.395	-0.078	-0.397	-0.078	-0.389
TGT NAT_HK	0.085	0.954	0.092	1.019	0.085	0.906
TGT NAT_MA	0.061	0.704	0.068	0.773	0.060	0.647
TGT NAT_CN	0.100	1.196	0.108	1.266	0.102	1.156
TGT NAT_ID	0.078	0.785	0.083	0.826	0.078	0.762
TGT NAT_MC	0.071	0.505	0.077	0.544	0.076	0.532
TGT NAT_PH	0.012	0.110	0.012	0.114	0.012	0.110
TGT NAT_TW	0.087	0.869	0.097	0.951	0.083	0.781
R Square	0.222		0.225		0.230	

* significant at 10% ; ** significant at 5%; *** significant at 1%

Table 5-4 US, Dependent Variable: CARs (-20, +1)
- Ownership advantage measured by R&D, Advertising expenditure

Independent Variable	Model 7		Model 8		Model 9	
	Coefficient	t-ratio	Coefficient	t-ratio	Coefficient	t-ratio
RD/TA	-1.223	-2.115**	-1.210	-2.090**	-1.242	-2.141**
ADV/TA	-0.977	-1.610	-0.973	-1.600	-0.856	-1.405
RELATED	-0.073	-2.152**				
HORIZONTAL			-0.066	-1.901*		
VERTICAL			-0.095	-2.179**		
SAME BUSINESS					-0.061	-1.578
SIMILAR PROD					-0.073	-1.873*
SIMILAR CUSM					-0.111	-1.600
SIMILAR TECH					0.175	1.375
BUY SUPPLIER					-0.118	-2.050**
BUY BUYER					-0.082	-1.584
RELATED*RD	1.086	1.818**	1.051	1.752*	1.088	1.815*

Table 5-4 US, Dependent Variable: CARs (-20, +1) – Cont'd
- Ownership advantage measured by R&D, Advertising expenditure

RELATED*ADV	0.577	0.866	0.558	0.834	0.419	0.622
KNOWLEDGE OF TGT	-0.046	-1.355	-0.046	-1.372	-0.046	-1.341
EXPERIENCE	-0.085	-1.215	-0.092	-1.311	-0.106	-1.477
SQUARED EXP	0.099	2.056**	0.107	2.168**	0.116	2.303**
PAYMENT	-0.027	-0.576	-0.030	-0.646	-0.041	-0.874
NEGOTIATED	0.019	0.135	0.018	0.132	0.030	0.213
SIZE	-0.005	-0.860	-0.005	-0.878	-0.005	-0.831
CASH FLOW	-0.096	-0.695	-0.093	-0.671	-0.113	-0.814
LIABILITIES	-0.014	-0.164	-0.014	-0.170	-0.020	-0.235
PROFITABILITY	0.145	0.993	0.143	0.983	0.148	1.014
YEAR1985	0.090	0.787	0.094	0.819	0.076	0.657
YEAR1986	0.102	0.972	0.097	0.923	0.090	0.843
YEAR1987	0.104	0.968	0.101	0.937	0.095	0.875
YEAR1988	-0.136	-1.084	-0.143	-1.136	-0.154	-1.215
YEAR1989	-0.014	-0.115	-0.015	-0.124	-0.030	-0.242
YEAR1990	0.148	1.373	0.143	1.322	0.139	1.286
YEAR1991	0.066	0.741	0.067	0.754	0.016	0.170
YEAR1992	0.239	2.732***	0.243	2.774***	0.236	2.664***
YEAR1993	0.122	1.328	0.117	1.277	0.065	0.678
YEAR1994	0.152	1.637	0.163	1.732*	0.162	1.686*
YEAR1995	0.084	1.076	0.081	1.028	0.071	0.897
YEAR1996	0.058	0.800	0.057	0.779	0.062	0.827
YEAR1997	0.093	1.235	0.093	1.221	0.085	1.119
YEAR1998	0.123	1.654*	0.123	1.655*	0.118	1.572
YEAR1999	0.077	1.034	0.075	1.004	0.072	0.955
TGT NAT_HK	0.030	0.622	0.030	0.628	0.042	0.849
TGT NAT_MA	0.061	0.986	0.065	1.043	0.075	1.184
TGT NAT_SG	0.024	0.469	0.027	0.533	0.037	0.714
TGT NAT_CN	0.058	1.037	0.059	1.043	0.073	1.279
TGT NAT_ID	0.095	1.461	0.095	1.459	0.079	1.194
TGT NAT_PH	0.053	0.552	0.057	0.593	0.074	0.769
TGT NAT_SK	0.029	0.544	0.029	0.559	0.034	0.640
TGT NAT_TW	0.018	0.323	0.022	0.383	0.035	0.596
TGT NAT_VT	-0.059	-0.494	-0.054	-0.452	-0.038	-0.307
R Square	0.245		0.248		0.271	

* significant at 10% ; ** significant at 5%; *** significant at 1%

**Table 5-5 US, Dependent Variable: CARs (-20, +1)
– Ownership advantage measured by intangible assets**

Independent Variable	Model 10		Model 11		Model 12	
	Coefficient	t-ratio	Coefficient	t-ratio	Coefficient	t-ratio
IA/TA	0.024	0.102	0.022	0.094	0.054	0.225
RELATED	-0.038	-0.771				
HORIZONTAL			-0.034	-0.674		
VERTICAL			-0.059	-1.016		
SAME BUSINESS					-0.027	-0.523
SIMILAR PROD					-0.039	-0.729
SIMILAR CUSM					-0.061	-0.762
SIMILAR TECH					0.233	1.701*
BUY SUPPLIER					-0.072	-1.044
BUY BUYER					-0.048	-0.747
RELATED*IA	0.018	0.065	0.018	0.065	-0.008	-0.029
KNOWLEDGE OF TGT	-0.033	-0.959	-0.034	-0.975	-0.032	-0.907
EXPERIENCE	-0.095	-1.351	-0.101	-1.423	-0.112	-1.557
SQUARED EXP	0.111	2.263**	0.117	2.346**	0.125	2.435**
PAYMENT	-0.033	-0.691	-0.035	-0.746	-0.048	-1.017
NEGOTIATED	0.064	0.453	0.064	0.452	0.079	0.555
SIZE	-0.007	-1.159	-0.007	-1.177	-0.007	-1.115
CASH FLOW	-0.143	-1.087	-0.144	-1.093	-0.161	-1.224
LIABILITIES	0.026	0.304	0.027	0.315	0.024	0.276
PROFITABILITY	0.144	0.961	0.143	0.954	0.144	0.961
YEAR1985	0.061	0.500	0.065	0.531	0.041	0.333
YEAR1986	0.084	0.754	0.081	0.724	0.066	0.579
YEAR1987	0.089	0.813	0.086	0.786	0.073	0.661
YEAR1988	-0.145	-1.080	-0.150	-1.116	-0.167	-1.239
YEAR1989	-0.038	-0.294	-0.038	-0.298	-0.061	-0.470
YEAR1990	0.136	1.175	0.132	1.141	0.121	1.036
YEAR1991	0.026	0.247	0.028	0.266	-0.035	-0.321
YEAR1992	0.197	2.080**	0.201	2.114**	0.184	1.920*
YEAR1993	0.091	0.896	0.088	0.869	0.026	0.240
YEAR1994	0.128	1.287	0.138	1.367	0.127	1.240
YEAR1995	0.054	0.635	0.052	0.611	0.034	0.392
YEAR1996	0.024	0.295	0.023	0.292	0.018	0.218
YEAR1997	0.065	0.766	0.064	0.764	0.050	0.590
YEAR1998	0.096	1.154	0.097	1.164	0.085	1.005
YEAR1999	0.039	0.463	0.038	0.451	0.025	0.294
TGT NAT_HK	0.017	0.320	0.017	0.325	0.033	0.608
TGT NAT_MA	0.054	0.833	0.057	0.882	0.070	1.064
TGT NAT_SG	0.016	0.308	0.019	0.360	0.034	1.626
TGT NAT_CN	0.042	0.722	0.043	0.732	0.061	1.030

**Table 5-5 US, Dependent Variable: CARs (-20, +1)
– Ownership advantage measured by intangible assets**

TGT NAT_ID	0.096	1.411	0.096	1.409	0.083	1.209
TGT NAT_PH	0.052	0.537	0.056	0.575	0.081	0.835
TGT NAT_SK	0.008	0.138	0.008	0.150	0.017	0.315
TGT NAT_TW	-0.002	-0.029	0.002	0.026	0.020	0.318
TGT NAT_VT	-0.083	-0.669	-0.016	-0.144	-0.063	-0.494
R Square	0.196		0.198		0.223	

* significant at 10% ; ** significant at 5%; *** significant at 1%

Table 5-5 Summary of Hypotheses and Findings – Entire Sample

Hypothesis	Finding
H1: Acquirer performance is positively related to the quantity of intangible assets possessed prior to the acquisition.	Supported
H2: Both related and unrelated M&As generate positive gains to the acquiring firms.	Partially supported
H3: Acquirer performance is positively related to the interaction of the quantity and relatedness of intangible assets possessed prior to the acquisition.	Contradictory
H4: Acquirer performance is positively related to the level of acquirer's knowledge about the target firm prior to the acquisition.	Insignificant
H5: Acquirer performance is positively related to its prior experience in undertaking M&A activities.	Supported

Figure 3-1: Factors Influencing M&A Performance

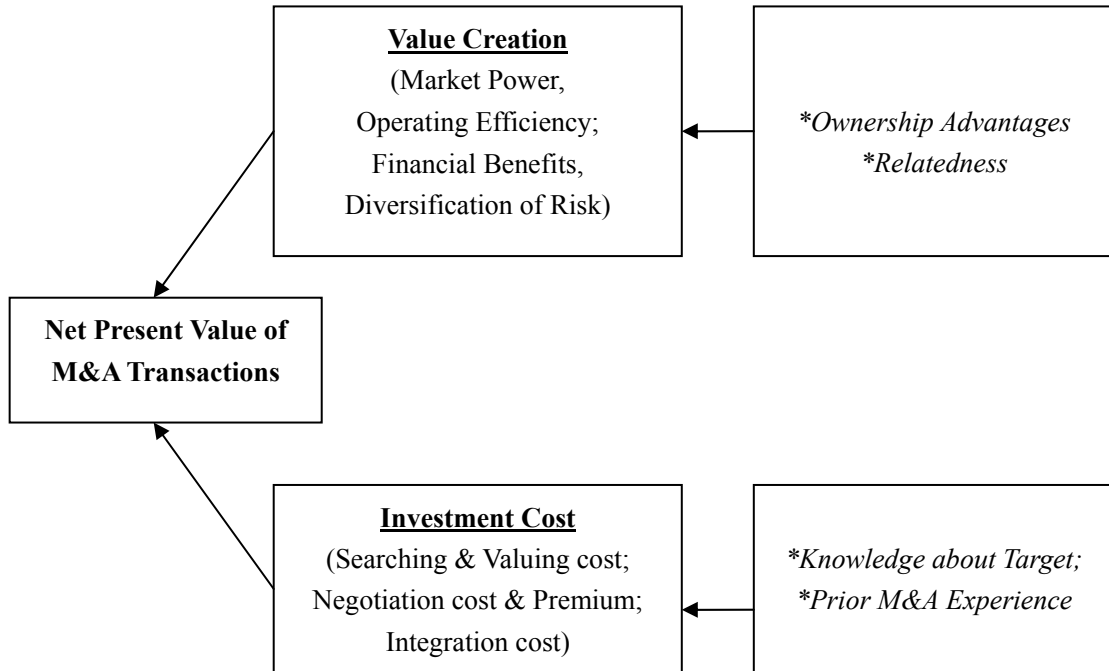


Figure 4-1 The Distribution of M&A transactions during 1985-1999

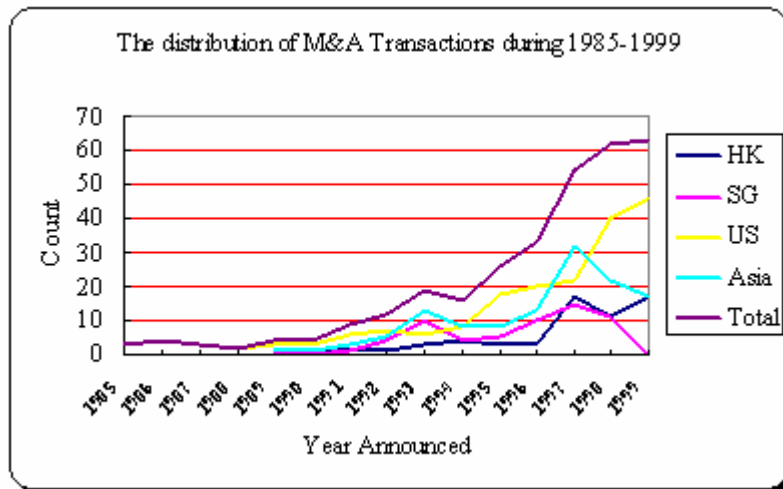
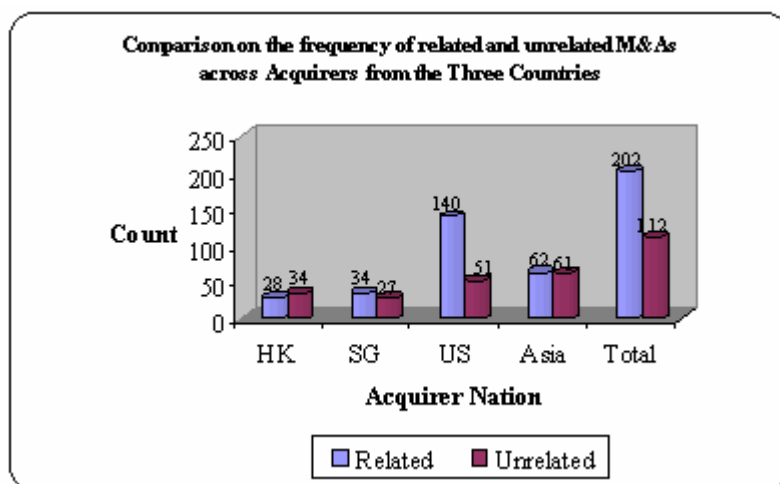


Figure 4-2 The Comparison on the frequency of related and unrelated M&As across Acquirers from the Three Countries (Hong Kong, Singapore and U.S.)



CHAPTER 1 INTRODUCTION

1.1 Background

The dramatic changes in the world business environment – new technologies, reforms to regulatory frameworks, and the continued development of capital markets – have presented firms with many new business opportunities, and risks as well. In response to such a changing environment, many firms have undertaken cross-border mergers and acquisitions (M&As) to defend and enhance their competitive positions. Cross-border M&As can enable firms to quickly build and employ assets in different countries. Cross-border M&As can also create a new platform for firms to restructure their existing operations globally to exploit economies of scale / scope and obtain other strategic advantages (Seth, 1990a; 1990b; Markides & Oyon, 1998; Capron, 1999; UNCTAD, 2000).

Even though there are these potential benefits, the bulk of empirical studies on the performance of the M&As have shown that most M&As fail to realize the expected gains. In the finance literature, researchers use an event study methodology to examine the stock price reaction to M&A activities. In the industrial organization literature, accounting data has been used as an alternative assessment to measure the performance of M&As. Most of the studies in both streams show that a large number of M&As are not successful as they do not produce better results, in terms of stock price and profitability, than those firms not engaging in M&As (Ravenscraft & Scherer, 1987; Rangan, et al., 1994; Bild, 1998; Markides & Oyon, 1998).

Almost all of the existing empirical work, such as that cited above, has been based on acquisition data from the United States, the United Kingdom, and other developed countries. There is scant evidence from the context of Asia.

This thesis is motivated in part by the empirical need to investigate the performance of cross-border M&As in Asia. International merger and acquisition activities in Asia have several points of interest. First, statistics show an obvious boom of cross-border M&As in Asia. According to UNCTAD's World Investment Report (2000: 52), "cross-border M&As in South, East, and South-East Asia reached an annual average \$20 billion during 1997-1999, compared to an average of \$7 billion during the pre-crisis years of 1994-1996."

On one hand, the efforts of the most countries in Asia to attract foreign direct investment (FDI) have built a more favorable business environment for investors. The deregulation policy and developments on legislation and accounting systems have facilitated firms to undertake mergers and acquisitions. On the other hand, increasingly intense global competition has forced firms to keep looking for new business opportunities to survive and prosper. Asia is considered to be a huge promising market, with regard to both its cheap factors and to its growing consumption needs as accompanied by the economy recovery and growth of the region. M&As can provide firms with a rapid access to this potential market. Hence, it is important to study cross-border M&As in Asia to understand FDI and economic growth in this region.

Second, it is interesting to study M&As within the context of Asia because of the

unique features of countries in this region. Given the special context of Asia in the sense of its relatively lagged development in the markets for corporate control, it is a reasonable question to examine whether the M&As in Asia perform as those undertaken in the developed country context. In explaining the unsatisfactory performance of M&As in developed countries, researchers point out that the high acquisition premium and the complex post-acquisition integration could be the major reasons for the poor performance. For firms to actually benefit from M&As, there must be net benefits in the M&A, meaning the value created through acquisitions should be larger than the premium paid plus the cost of post-acquisition integration.

In developed countries, which have relatively mature and efficient financial and informative markets, it is quite usual that the competition among potential bidders would drive up the target price, ending up with, at best, zero net benefits for the final acquirer (Capron & Pistre, 2002). In Asia, in contrast, the market for corporate control in many countries is imperfectly competitive, which might facilitate acquiring firms to obtain abnormal returns through an M&A.

The information on target firms in Asian countries is not as transparent and public as in the United States and the United Kingdom. The early stage of development of stock markets in developing Asian countries can reduce the extent of competition among potential bidders in an M&A. Furthermore, scholars pointed out that the assets of many Asian firms were significantly undervalued after the financial crisis, which resulted in a number of M&As being dealt at a rather low price, in a so called “fire sale” (for example, see Singh & Yip, 2000). As a result, there could be

favorable opportunities for cross-border M&As in Asia. In this thesis, I attempt to understand the performance of cross-border M&As in this Asian context.

As stated above, this study is motivated by the increasing trend of cross-border M&As in Asia and the special features of the Asian context and Asian firms. Specifically, the major purposes of my thesis are to:

1. Examine the performance of cross-border M&As in Asia;
2. Investigate the determinants of acquirer performance

1.2 Contributions

This thesis contributes to research on mergers and acquisitions in two ways. First, it expands the empirical context for cross-border M&As research by framing the work in the context of Asia. Second, it enriches the conceptual and theoretical work on cross-border M&As by investigating a comprehensive list of determinants of acquirer performance.

Previously, few studies in the M&A field have focused on the special context of Asia; instead, most studies were based on M&As that took place in developed countries. There is a general need to include Asia as an empirical context, since the existing research findings from developed country studies may not be applicable. Asia represents a special and different case; the relatively inefficient markets for capital and information and the specific post-crisis period in Asia might possibly help acquiring firms to avoid overpaying in their acquisition premium, which in turn

enabled these firms to capture the net benefits of acquisitions. By comparing the findings of Asian context with those of developed economy setting, we can have a better understanding of whether institutional factors matter in the M&A performance issue.

This study also extends the existing literature on M&As by developing a conceptual model to investigate the determinants of acquirer performance. In the existing literature, researchers have identified several influential factors of M&A performance. However, there has not been an ideal way to frame these factors into one comprehensive picture, with perhaps missing determinants. Further, the empirical findings of these effects are far from conclusive. I try to enrich this research area by providing a conceptual model that not only identifies the elements influencing the potential value creation within M&As, but take into account the elements determining the total costs of M&A investments as well.

1.3 Findings

To make this investigation, I use a sample of 314 cross-border M&As undertaken in Asia between 1985 and 1999. These 314 transactions were conducted by firms from the U.S., Hong Kong, and Singapore in 11 Asian countries. I define the acquirer performance as the cumulative abnormal returns (CARs) to the acquiring firms over the event period. I retrieved information on the 314 acquisitions from the “World M&As Databases” on the SDC Platinum. I obtained supplementary information from

CRSP, PACAP, Worldscope, and etc. I gathered the CARs for U.S. acquiring firms through the EventUs software available on the website of Wharton Research Database Center. I calculated the CARs for Asian acquirers according to the standard procedures in event studies.

The Patell Z tests in this study show that on average, acquirers earn insignificant abnormal returns from cross-border M&As in Asia. Further, the results for tests on subsamples show that only the U.S. acquirers enjoy significantly positive returns of 1.12 percent; acquiring firms from Hong Kong and Singapore neither win nor lose significantly from M&As.

The results for OLS regressions support part of the hypotheses, that is, 1) acquiring firms with superior ownership advantages would enjoy better performance, 2) related M&As are expected to generate more benefits to acquirers than unrelated M&As, and 3) the tests also find a significant U-shape relationship between acquirer performance and acquisition experience. On the other hand, contradictory to my original expectation, the results show that 4) the positive effect of intangible assets on acquirer performance is weakened if the acquiring firm is undertaking a related M&As instead of an unrelated one. In addition, I do not find significant support to the hypotheses on the effect of acquirer's knowledge about the target firm.

1.4 Organization

This thesis has six chapters. This first chapter described the motivations, contributions,

and findings of this thesis. Chapter 2 provides a review of the literature on mergers and acquisitions. In the third chapter, I develop my hypotheses concerning the determinants of acquirer performance. Chapter 4 describes the data and methodology. I report the results of my statistical tests in chapter 5. I discuss the results in chapter 6. Also, in chapter 6, I outline the conclusions, limitations, implications and future directions associated with this thesis.

CHAPTER 2 LITERATURE REVIEW

Academic research on mergers and acquisitions is just as intense and dynamic as the M&A activities undertaken in the business world. In this chapter, I will review the studies on M&As that have been done during the past half century. I will review three areas of research: 1) the literature on motivations for M&As; 2) the studies on the performance of M&As; 3) the limitations in the existing literature on M&As.

Researchers have proposed various hypotheses to explain the motivations for M&A activities. These mainly includes the operating efficiency hypothesis, the market power hypothesis, the diversification hypothesis, and other non-value-increasing hypotheses such as the managerial discretion hypothesis (Schumpeter, 1934; Marris, 1963), the cash flow hypothesis (Jensen & Ruback, 1983) and the hubris hypothesis (Roll, 1986).

The performance of M&As has also received much attention in this research area. Two types of methodologies have been widely used: event studies and outcome studies (Tichy, 2001). Most event studies have found that the shareholders of the target firm enjoy abnormal return of 20-30% around the time of announcement while the acquirer's shareholders more or less break even. An extended event window reveals a declining trend of abnormal returns to the acquiring firm's shareholders (Agrawal, et al., 1992; Loughran & Vijh, 1997; Conn et al., 2001). On the other hand, industrial organization economists have adopted outcome studies to compare the pre- and post-acquisition performance, or compare the M&A performance with that of matching firms. Most outcome studies find a profit deterioration effect of the M&A

investments (Mueller, 1980, 1985; 1986; Cosh et al., 1989; Ravenscarft & Scherer, 1987, 1989)

The literature of M&A is influenced by two key issues: first, the findings about the influential factors of M&A performance are inconclusive. Although researchers have identified some elements such as relative size, relatedness, and payment mode, evidence on the impact of these factors on M&A performance is not conclusive and many other factors are absent on the list. Second, the researchers in this area have paid scant attention to the M&As undertaken in the context of Asia. Almost all the studies have chosen a developed economy (especially U.S. and U.K.) as their research setting. As an M&A boom has been emerging in Asia, there is an increasing need for researchers to take a closer look into the M&A stories that have happened in this region.

2.1 Why do firms undertake M&As?

A number of hypotheses have been proposed to explain the driving forces of M&As. M&A is considered as a tool for firms to response to the changing business environment. Capron (1995) does a historical analysis of three waves of M&As in the United States, and she identifies that M&As can be viewed as firms' strategic responses to the changing business environment. Technological development, the introduction of mass production techniques and transportation development, and other institutional elements such as anti-trust legislation and stock market vitality all are the

triggering factors that impel firms onto the arena of M&As.

In addition to the macro-level driving forces, strategic researchers pay more attention to the micro-level motivations of M&As. Generally, the literature categorizes such motivations into two broad groups: value-increasing and non-value-increasing (Seth, 1990a).

2.1.1 Hypotheses about M&As driven by value-increasing motives

Value-maximizing arguments predict an increase in the value of the acquiring and target firms. According to the definition by Seth (1990a), value creation is realized by making the best of a firm's assets and resources under the environmental opportunities and constraints faced by the firm. In an M&A, the combination of various resources of both the acquirer and the target provides the basis for value creation. There are a number of hypotheses about the value-enhancing motivations for M&As. Here, I divide the motivations into four categories: 1) enhance market power; 2) improve operating efficiency; 3) financial benefits; and 4) diversification of risk. Each motivation is reviewed in turn.

Market power. The dominant-firm model of oligopoly implies that prices will rise as a consequence of an acquisition by a dominant firm (Seth, 1990a). By taking over existing competitors, firms as market participants, can reduce the competition in the market and strengthen their ability to control price, quantity, or the nature of products, generating abnormal profits as a result. In the high-tech markets, mergers

and acquisitions can provide the small market followers with a good opportunity to achieve a greater size so that they might be better able to share their operating and R&D costs and improve their competitive positions in the market. Empirical studies have provided evidence that market power serves as a source of value creation in mergers and acquisitions (Eckbo, 1983; Stillman, 1983).

Operating efficiency. Hypotheses about operating efficiency refer to firms undertake M&As with the goal of achieving economies of scale or scope by pooling the production, R&D, marketing, HR, and management resources of the merging firms (Kitching, 1967; Seth, 1990a).

Synergistic gains are widely cited as an important justification for M&As. Managers would consider M&A as an attractive tool to enhance purchasing power (more likely to obtain a quantity discount) and to justify more expensive but more efficient machinery (Kitching, 1967). In addition, through pooling of technological or marketing resources, M&As could help to eliminate or redeploy redundant capacities, thereby reducing the total cost and in turn enhancing the performance of the firms (Porter, 1980; Seth, 1990a).

Financial benefits. Wiggins (1981) pointed out that scale economies can also be attainable when large firms raise money in capital markets. Given that an internal capital market could be built up through M&A, especially when the income streams of merging firms are imperfectly related, the viability of net cash flow and the risk of bankruptcy are reduced. Therefore, a firm's ability to borrow is correspondingly improved, which might potentially enhance the firm performance.

Diversification of risk. Compared with the previous three points which have received common recognition, the risk diversification argument is more controversial. Some scholars considered it to be a motive for M&As, while others do not. The proponents argue that by following the logic of financial benefits, acquiring a different business can smooth the variance of a firm's returns, thereby leading to a reduction of risk.

But this argument also induces many objections. Some scholars have pointed out that under the assumption of perfect capital markets, individual investors can duplicate this risk pooling through personal portfolio diversification (Seth, 1990a). Under such circumstances where risk-averse investors optimally hold diversified portfolios, only systematic risk will matter in pricing a security. However, systematic risk cannot be reduced by diversification, and therefore no value would arise from this risk pooling by company diversification. Only in the presence of market imperfections such as high information costs (Lintner, 1971), can we expect this risk pooling to create value in mergers and acquisitions.

I include this idea as a hypothesis as one of explanations for cross-border M&A motivations. This is mainly because of the presence of barriers in international capital markets. In global markets, it is more difficult for individual investors to access to foreign capital for his/her portfolio diversification than for a company to infuse its capital into foreign businesses for its diversification.

2.1.2 Hypotheses about non-value-increasing motivations

In addition to the various hypotheses that expect M&As to be a value-enhancing tool for firms, researchers have also proposed another set of arguments stating that M&As might be driven by some other factors which are unrelated to value enhancement. Among such arguments, the hubris hypothesis and the managerial discretion hypothesis are the most widely cited explanations.

The hubris hypothesis. Roll(1986) explained the “winner’s curse” by suggesting that managers of the acquiring firm might suffer from “hubris”. He pointed out that each manager is likely to be over-confident in his or her ability to better manage the acquired assets than the average acquirers. Especially during high market cycles, speculative fever is booming with the stock market, which would also amplify acquirers’ expectations about the value of target firms (Markham, 1955; Gort, 1970; Pangarkar & Junius, 2004). Because of the over-confidence of acquirer managers, they might not be able to really spot value in the target; instead, they tend to overpay and lead to a loss in the wealth of acquirer’s shareholders.

The managerial discretion hypothesis. This hypothesis postulates that M&As may be driven by managerial efforts to pursue personal gains at the expense of stockholders’ interests. (Jensen 1986; Morck et al. 1990) For managers as the agent of a firm, their compensation is usually linked with the sales or assets of the firm. Baumol (1967) pointed out that individual managers might try to enhance their power, prestige, job-security and salaries by seeking corporate expansion or controlling a large empire. Especially when corporate governance is weak, managers can pursue

their own interests even if the expansion of the firm is beyond the optimal size that maximizes the welfare of stockholders (Jensen 1986).

Mergers and acquisitions motivated by this managerial discretionary behavior have no synergistic gains to be allocated among the firms. Under the goal of “empire building”, managers tend to be willing to overpay for the target firms (Eun et al. 1996). Acquisitions of this non-value-maximizing type could probably be an overall economic loss (Halpern, 1973).

Mathur et al (1994) also pointed out three types of managers might probably demonstrate this managerial discretionary behavior: managers of firms with free or excess cash flows, manager of firms in declining industries, and managers of firms in slow-growth economies with limited investment opportunities.

2.2 M&A Performance

Broadly speaking, the empirical research on the performance of M&As has been conducted in two major approaches: event studies, and outcome studies. The first one is commonly applied in the finance literature, whereas the second one is more frequently used by industrial organization economists. In my thesis, I follow the standard methodology of event studies to examine acquirer performance. But before I review in more details the event studies on M&A performance, I briefly discuss about the outcome studies that have been conducted in the literature of M&A.

2.2.1 Outcome studies

Industrial organization economists use outcome studies to examine the performance effect of M&As. Using the stock market response as a measure for M&A performance, outcome studies compare the pre- and post-acquisition performance, and compare the merging firms with matching firms or the base industry (Tichy, 2001). Table 2-1 lists several outcome studies on M&As.

Scherer (1988) has argued that it is better to investigate the impact of M&As by looking directly at a firm's profitability at the time an M&A occurs, and the changes in their profit performance over a substantial period of time following M&As. Through the analysis of accounting data, scholars should therefore be able to learn what actually happened after merger. But the empirical findings of outcome studies did not provide any compelling evidence about M&A performance.

Mueller (1986) studies a sample of 551 U.S. manufacturing firms that undertook M&As during the period of 1950-1972, and he found that compared with the matched firms, the firms included in his sample suffered a significant loss in both market share and the rate of return on equity. Ravenscraft & Scherer (1987) find similar results by examining a sample of about 6,000 acquisitions completed during 1950-1977. They also investigate the effects of purchase mode and hostile takeovers on M&A performance, and they revealed a significant deterioration effect of M&A.

In the UK setting, by comparing the pre- and post-merger profitability (measured by ROA) relative to the industry average, Meeks (1977) reveals in his sample of 233 UK acquiring firms (1964-1972) that acquiring firms suffer a substantial decline in

their profitability after an acquisition. In some cases, the loss amounts to a subnormal return of -50 percent. Other studies (Hoshino, 1982; Lang et al., 1989; Cosh, et al. 1989, etc.) also find negative performance effects of mergers and acquisitions.

However, there are several limitations with the outcome studies approach. First, for the before-and-after analyses, problems may occur when the target firm is quite small relative to the acquirer, for example, with less than five percent of the acquiring firm's assets on average. In such a case, whatever weighted average financial performance the target firm contributes to the M&A is likely to be "swamped" within the consolidated reports for the whole corporate entity (Ravenscraft & Scherer, 1987).

Second, there is a different difficulty in analyses using similar firms as control groups. For example, the large U.S. corporations of the 1970s were active merger-makers and also highly diversified. Therefore, it is difficult to establish a control group of firms with similar size and industrial roots but not involved in M&As (Ravenscraft & Scherer, 1987).

Third, another critical limitation of the outcome studies is concerned with the application of accounting data. As the information on the financial sheets usually reflects how well the whole business operations are performing over a certain period, such accounting data might include information about many events which occur during that period, not exclusively about the M&A transaction. However, the event studies can deal with this problem properly.

2.2.2 Event studies

Event studies are used to analyze stock market reactions to the events that occur at the time of an M&A or in its aftermath. This approach generally assumes that the stock market is efficient and therefore changes in the share prices of the acquiring and target firms reflect the value of the economic impact of an acquisition, after controlling for the general market movements and systematic risk. In Table 2-2, I list some selected event studies on M&A performance.

The results from various event studies suggest that the impact of an acquisition on a target firm is positive. Within a several-week time “window” around the event (that is, the announcement of the M&A), the target’s stock price rises sharply so that the stockholders of the target firm earn substantial positive abnormal returns (Dodd & Ruback, 1977; Bradley, 1980; Bradley et al., 1983; Asquith, 1983; Eckbo, 1983).

On the other hand, the results for acquiring firms are less consistent. About one-third of the studies on published shareholder value indicated a positive effect for the acquiring firm (Schenk, 2000). For example, Asquith et al. (1983) examined 214 merger bids initiated by Fortune 1000 firms during the period from 1963 to 1979. A time period from 20 days before until the announcement day was used as the event window. Their study shows that the average cumulative abnormal return is 2.8% at a statistically significant level. Furthermore, by controlling for the relative size of merging firms, for the time period in which the merger is undertaken, and for the eventual outcome of the bid, the authors find even larger abnormal returns. Bradley et al. (1988) also find that acquiring firms in the United States earned positive returns

during the unregulated period of 1963-1968.

But other studies have shown that a bidding firm's shareholders generally break-even or lose. Dodd (1980), and Asquith (1983) find that acquiring firms earn either zero or small negative but significant returns; Loderer and Martin (1990), in a study of takeovers, show that bidders obtained negative but insignificant returns in the period of 1981-1984, which is consistent with the findings by Bradley et al. (1988) for the same time period.

The evidence above is consistent with the findings of Jensen & Ruback (1983) and Jarrell et al. (1988). Overall, M&As create value for shareholders of the target and acquirer as a whole; however, most of the gains accrue to the target firm's shareholders. Shareholders of acquiring firms are assuming the risk of actually suffering a loss from the transactions.

In contrast to the traditional wisdom of using the announcement-period as the event window, several recent papers extend the length of time horizon examined (Loughran & Vijh, 1997; Rau & Vermaelen, 1998; Mitchell & Stafford, 2000; etc.). The long-horizon event studies tend to reveal a negative drift in the stock prices of acquiring firms. For example, Loughran & Vijh (1997) find the abnormal returns over the 5-year period after the M&A announcement are -24.2 percent for acquirers financing by stock. Megginson et al. (2000) use a sample of 204 acquisitions undertaken during the period of 1977-1996 and find acquirers suffer a loss in abnormal returns of -13 percent within a 3-year period an M&A has been implemented.

Event study analysis also has its own limitations. Its assumption of stock market efficiency has induced a variety of objections. Basically, an event study investigates the market expectation of an M&A's consequences. However, the stock market's reaction may not be necessarily correct in its prediction. The best available information may not be easily accessible. Therefore, it is questionable whether stock prices reflect the true value of firms. In this sense, event studies are not the best approach to be applied in a research setting with underdeveloped capital markets. But in this thesis, as the United States, Singapore and Hong Kong are developed economies, it is to some extent justifiable to use event studies to examine M&A performance.

2.3 The limitations in the existing literature of M&A

The literature of M&A has not developed a comprehensive framework to identify the determinants of M&A performance. In addition, studies focusing on the developed economy setting account for a dominant proportion in the existing literature, with little attention given to M&As that occur in the developing countries. In this section, I first discuss some of the existing studies on the determinants of M&A performance, and then I provide a review of the M&A trend in Asia and the few studies that have been conducted on this context.

2.3.1 The literature on determinants of M&A performance

This research area is influenced by two issues: 1) findings about the performance effect of the identified factors are not consistent; 2) there are numerous other influences that could be considered.

Relatedness. This is one of the controversial factors that might impact the performance of an M&A. The research question, “whether different acquisition strategies (in terms of relatedness) are associated with different degrees of economic gains”, has received intense discussion among strategy researchers. However, the empirical findings are not so clear cut. Singh & Montgomery (1987) study a sample of 105 large mergers that were conducted between 1975 and 1979. Their results show that related mergers enjoy better abnormal returns than unrelated mergers. Yet Chatterjee (1986), Elgers & Clark (1980) find that conglomerate mergers produce better wealth effects for shareholders of both the acquirer and target than non-conglomerate mergers do. On the other hand, other work reveals no significant performance differentiation across the different types of mergers and acquisitions (Wansley et al., 1983; Lubatkin, 1987; Seth, 1990b; etc.)

Relative size. Asquith et al. (1983) point out that the stock market reaction for acquiring firms will vary with the relative size of acquirer to target firm. They divided the sample into two groups, bids in which the target firm’s equity value is greater than 10% of the acquirer’s value and bids where the target’s value is less than 10%. They find cumulative abnormal returns are significantly greater when the target’s value is larger than 10%. Over the event period of (-20,0), the cumulative abnormal return to

the bidders is 4.1%, when the target's value is larger than 10% of the bidder's value; in contrast, in the comparing group (less than 10%), bidders only obtain a cumulative abnormal return of 1.7%.

However, other researchers argue that smaller targets (less than 10% of the acquiring firm) are much easier to integrate and consequently reduce the failure rate (Copeland, et al., 1994). Further, another problem is identified in testing this factor: the relevant information about the target size is not easily accessible (Morck & Yeung, 1992).

Payment mode. Payment by cash or stock is another commonly tested factor in studies of M&A performance. Basically, the idea is that when the managers of the acquiring firm perceive the equity is overvalued by the stock market, they are more likely to choose stock-financing for their M&A investment (Myers & Majluf, 1984). However, such information will be conveyed along with the equity issue, and the outsider investors will bid down the stock price of the acquiring firm.

The question is, should this be considered as a factor related to M&A performance. Andrade et al. (2001) points out that stock-financed M&As could be considered as two simultaneous transactions: an M&A transaction and an equity issue. It is the second issue that is impacted by the stock-financing. Should we link the payment mode to the performance of M&A transaction per se?

Market cycle. Researchers argue that low market cycles can provide better acquisition opportunities for two major reasons (Pangarkar & Junius, 2004). First, during low market cycles, managers are less likely to be affected by hubris and more

likely to avoid overpaying for the target. Second, during low market cycles, there is more likely to be a recognition of the need for reform among a firm's shareholders, employees, and creditors (Barton, et al., 2002), therefore it is much easier to implement post-acquisition restructuring (Pangarkar & Junius, 2004).

However, this market cycle argument has not been tested widely, with the exception of Kusewitt (1985), Lubatkin & Chatterjee (1991), and Pangarkar & Junius (2004). These studies report significant support of the market cycle argument.

2.3.2 M&As in Asia

There has been a rapid increase in M&A activities in Asia in recent years. Studies indicate that there has been a boom of cross-border M&As in Asian countries in the past 10 years (UNCTAD's World Investment Report, 2000). Basically, two types of cross-border M&As occur in this region: firms of developed countries (especially U.S. and West Europe) acquiring Asian targets, and intra-regional cross-border M&As (usually firms from Singapore and Hong Kong acquire firms of other countries in this region).

Although the M&A transactions in Asia are becoming more frequent, little research attention has been paid on this area. Even within the few exceptions, the findings about the acquirer performance are not conclusive. (Table 2-3) Koh and Lee (1988) find zero returns to acquiring firms based on their study on a sample of 85 M&A transactions that were conducted during the period of 1973-1984. Pangarkar

and Junius (2004) use a larger sample (115 acquisitions) and find robust support for significantly positive returns. In contrast, Lee et al. (1997) investigate 39 acquisitions completed between 1983 and 1992, and they conclude acquiring firms experience positive returns from M&As. Further, no significant returns are reported by Ding et al. (1996).

2.4 Summary

As reviewed in this chapter, the literature on M&As is a dynamic research area. In prior research, a number of hypotheses have been proposed to explain why firms undertake M&As, and debates exist on the determinants of performance of M&As. On the other hand, however, the findings about the determinants of M&A performance are far from conclusive, and the Asian context has not received much research attention. My thesis addresses these two issues by investigating the influential factors of acquirer performance (Chapters 3) as tested by a sample of cross-border M&As undertaken in Asian countries (Chapters 4 and 5).

CHAPTER 3 HYPOTHESES DEVELOPMENT

There have been a large number of studies on mergers and acquisitions undertaken in developed countries, but there is little research focusing on the context of M&As in developing countries, especially on the M&A stories of Asia.

Facing increasingly intense global competition, multinational corporations (MNCs) have tended to shift their production bases to countries with relatively low labor costs. Asia is just one of the target regions. Further, accompanying two decades of high economic growth, the emerging rise of significant consumer demand in Asian countries has also attracted significant investments from MNCs, especially those from North America and Europe. At the same time, most governments of countries in Asia have been making an effort to build up a more favorable business environment for foreign investors. Statistics clearly identify a corresponding boom of cross-border M&As in Asia: cross-border M&As in South, East, and South-East Asia reached an annual average of USD \$20 billion during 1997-1999, while during the pre-crisis years of 1994-1996, it was just an average of \$7 billion (UNCTAD's World Investment Report, 2000).

However, compared with developed countries, Asia may yield a much different story for the acquisitions of MNCs. In the U.S. and Europe, focus on core businesses seems to be the main stream approach of corporate strategies; but in Asia, many of the institutions supporting Western companies' business activities are absent. Will the focused strategies still be beneficial to the M&As transactions in Asia? Further, given the existence of a large number of private firms, merger and acquisition in Asia activities tend to be mainly undertaken not through the stock market, but through

private negotiations. What will we find about the performance of M&As undertaken in the Asian countries, given this difference? What will be factors that influence the performance of an acquisition consummated in the developing countries, rather than in a typical developed country setting? Will the results about the performance of acquisitions, for example, be different as compared with those based on the U.S. or UK experience? If there is any difference, what could be the reason behind the difference? This chapter identifies the hypotheses that address these questions.

The conceptual model underlying this thesis, which I will explain in more detail in this chapter, is illustrated in Figure 3-1.

To address the research question, “What are the factors influencing the performance of M&As in Asian countries?”, I adopt the following underlying logic. The performance of M&As on the stock market depends upon the market’s valuation of the net present value (NPV) of the M&A transactions. Because the NPV of an M&A is decided by two parts, value created by the transaction and the cost of this investment, I try to transform the research question into identifying the factors that influence the realization of value creation and the factors that determine the investment cost of an M&A transaction. Following the logic described above, I investigate my suspicion that the stock market performance of the acquiring firm in an M&A would be influenced by 1) the acquirer’s ownership advantages; 2) the business relatedness between the acquiring firm and the target firm; 3) acquirer’s knowledge about the target firm; and 4) the acquirer’s experience of M&A activities. The former two determine the acquiring firm’s ability to create value in the M&A, whereas the latter two influence the cost of an M&A transaction.

3.1 Factors influencing value creation

In the context of an M&A, value creation is a process which involves combining and making optimal use of the two merging firms' specialized resources (technology, production, marketing, finance, human resource, etc.) (Seth, 1990a). Therefore, we can expect that the achievement of value creation is highly related to two factors:

- 1) The resources that are productive and transferable within the M&A;
- 2) The conditions for the combination and reconfiguration of the resources.

In the following sections, I will discuss the impact of acquirer's ownership advantages on the M&A performance first, and then the relationship between business relatedness and firm performance. This is followed by my analysis of the interaction between the ownership advantages and business relatedness.

3.1.1 Ownership advantages of the acquiring firm

Internalization theory (Caves 1971, Buckley & Casson 1976; Hymer 1976) indicates that foreign direct investment could create value for an MNC when a firm is able to exploit internally its firm-specific intangible assets. Such assets commonly include technological know-how, marketing ability, and effective management (Morck & Yeung, 1992).

Caves (1986) posits that intangible assets have certain characteristics of public goods. The value of these assets should increase in proportion to the scale of a firm's markets (Morck & Yeung, 1992), which means that such superior intangible assets could potentially add value to the firm when foreign direct investment occurs.

However, a firm must internalize the market for these assets in order to realize their latent, potential additional value. According to internalization theory, the market

for the resources outlined above is characterized by a variety of imperfections such as information asymmetry, immobility, and risk of misappropriation. Firms may have different perceptions of the value of a strategic resource; and many strategic resources are intangible, which makes it more difficult to value the resources in question. Further, the immobility of resources implies that firms' resources cannot be readily traded on the market. Even if such resources could be traded on the market, market exchange can be accompanied by high risks of misappropriations. Given the substantial transaction costs on the market for firm resources, firms must internalize the market to reap the competitive advantages of making such an acquisition of resources.

Based on the arguments above, we can observe that intangible assets could add value to MNCs' foreign direct investment, and such additional value could be realized only when an MNC internalizes the market for its intangible assets. Using this logic, I argue that when firms possessing superior intangible assets expand their businesses abroad through cross-border M&As, they are able to reap the rewards arising from internally applying their intangible assets over an increased scale. This should be then reflected in a firm's market value.

Morck & Yeung (1992) studied a sample of 322 foreign acquisitions by U.S. firms between 1978 and 1988 and they find that firms possessing information-based assets experience a significantly positive stock market response to the announcement of a cross-border acquisition. Markides & Oyon's study (1998) also provides strong support that cross-border acquisitions enable firms to optimize their firm-specific intangible assets and thereby increase the market value of these firms.

Therefore, I expect a positive relationship between the intangible assets of the acquiring firm and the cumulative abnormal returns to the acquiring firm.

Hypothesis 1: Acquirer performance is positively related to the quantity of intangible assets possessed prior to the acquisition.

3.1.2 Business relatedness between acquiring and target firms

In this section, I take a close look into how to realize the potential benefits of an acquisition by identifying the types of these benefits in an M&A, and then developing my second hypothesis about the performance impact of relatedness between merging firms.

As discussed in Chapter 2, the potential benefits in an M&A could be categorized into market power, operating efficiency, financial benefits, and risk diversification. Different degree of relatedness between merging firms provides the basis for realizing the various benefits in M&As. By related M&As, I refer to those in which acquiring firms and target firms conduct similar science-based research activities, employ similar production technologies, serve similar markets or use similar distribution systems (Rumelt, 1974). An M&A may be considered unrelated when the key success variables of two firms' businesses are unrelated. Market power and operating efficiency are associated with related M&As, whereas financial benefits and risk diversification are usually achieved in unrelated M&As.

When the acquiring firm targets a business characterized with similar R&D, production, marketing and distribution activities, it is more likely to improve its competitive position and strengthen its market power (Kitching, 1967; Seth, 1990a; Porter, 1980). For example, in some industries, firms have to achieve a critical mass of resources in order to effectively outperform the competition. Related M&As help

many small companies to attain a large size giving them sufficient cash flow to undertake R&D research to compete against entrenched companies. Related M&As also offer good opportunities for collusion (Stigler, 1968). Empirical evidence has shown that a dominant firm can benefit from a horizontal acquisition by strengthening its ability to control the price and quantity of the products it sold (Eckbo, 1983).

When the acquiring firms undertake related M&As, they can also potentially enhance operating efficiency. Researchers have proposed a number of arguments to explain how such benefits are generated in related M&As (Seth, 1990b; Baumol et al., 1982; Choi & Philippatos, 1983). Cost reductions can be realized through economies of scale in purchase, production, and inventory. Pooling of R&D, advertising, marketing, or management resources of two firms could also help to reduce relevant costs. Economies of scope are another source for the operating efficiency that could be generated through M&As (Seth 1990b).

As discussed above, the possibility in realization of market power and operating efficiency would be higher in related M&As, rather than in unrelated ones. In another word, if none of the components along the value chain is shared between two merging firms, we can hardly expect such benefits (market power, and operating efficiency) to be generated. However, in unrelated M&As, another two types of benefits might be potentially realized: financial gains and diversification of risk. Realization of financial gains and risk diversification require that the income streams of the business units should be imperfectly correlated; unrelated M&As just provide such a base for releasing these potential benefits.

Unrelated diversification through cross-border M&As can potentially generate financial gains in two ways. Firstly, diversified M&As can build up an internal capital market, to efficiently allocate cash across different units, and increase the liquidity of

the firm. For example, through unrelated M&As in which the earning streams of merging firms are imperfectly related, cash can be routed from units operating with a surplus to units operating with a deficit to make up for the latter one's concurrent deficiency (Kitching, 1967). Following this argument, as the variability of cash flow and the threat of bankruptcy are both reduced through an unrelated M&A, the company's ability to borrow would correspondingly be improved. As a result, the company's total cost of capital should thereby be lowered, which could provide stockholders with excess returns.

Diversification of risk is another argument to explain the potential benefits that could be generated in unrelated M&As. Although some researchers have argued that risk diversification through an M&A does not make much sense under the assumption of efficient capital market, it is still a potential source of value creation.

The opponents to the risk diversification hypothesis point out that in an efficient capital market, unsystematic risk can also be reduced by the investor's portfolio diversification as well as by company diversification, while systematic risk cannot be reduced either by portfolio diversification or by company diversification. Therefore, they posit that company diversification cannot provide stockholders with returns in excess of those available from a portfolio diversification. (Smith & Shreiner, 1969; Weston & Mansinghka, 1971; Mason & Gondzwaard, 1976)

Diversification of risk can provide acquiring firms' stockholders with excess returns when a cross-border M&A is undertaken in Asian countries. This is mainly because of the presence of barriers in international capital markets. Further, it is also difficult to acquire relevant information of the foreign businesses. Such barriers might prevent individual investors achieving an internationally-diversified portfolio. In contrast, companies can reduce unsystematic risk by diversifying into international

markets. Therefore, unrelated cross-border M&As could potentially generate financial synergies and risk diversification, which in turn improve the performance of an M&A.

In summary, I argue that related M&As can potentially enhance performance by generating market power and operating efficiency, while unrelated M&As can probably add value by realizing financial gains and risk diversification. From this perspective, I predict that both related and unrelated M&As could generate positive gains to the acquiring firms.

*Hypothesis 2: Both related and unrelated M&As
generate positive gains to the acquiring firms.*

3.1.3 Interaction between the relatedness and ownership advantages

If we combine the arguments in sections 3.1.1 and 3.1.2, we can illustrate the relationship between the different types of ownership advantages and the different types of M&As as in Table 3.1.

Hypothesis 1 has expected a positive relationship between acquirer performance and the ownership advantages that the acquirer possesses. In this section, I predict that such a positive relationship can be strengthened if the acquiring firm is undertaking a related M&A. There should be a basis for the leverage of ownership advantages: how much technological and marketing knowledge or resources could be applied in the acquisition would be largely constrained by the scope of the businesses in question. When the business lines of the acquirer and the target are related, that means the acquiring firm is expanding into a market characterized with similar production, technology, and marketing activities as in its original markets. Under such

circumstances, the ownership advantages such as technological and marketing know-how can be better transferred and applied in the target markets. Therefore, I predict a positive impact of the interaction between relatedness and ownership advantages on the acquiring firm's performance.

Hypothesis 3: Acquirer performance is positively related to the interaction of the quantity and relatedness of intangible assets possessed prior to the acquisition.

3.2 Factors influencing the cost of M&A

The net present value of an M&A is decided not only by the benefits that could be potentially realized through M&A, but it is also decided by the cost of undertaking such an investment as well. If we consider an M&A investment as a process involving searching and valuing targets, negotiation, execution and integration, we can then break the cost of such investment into three parts: searching and valuing cost, negotiation cost and premium paid, and integration cost. In the following three sections, I will analyze the factors that determine the three types of cost one by one.

3.2.1 Acquirer's knowledge about target firm prior to the acquisition

Searching and valuing targets is a preliminary but very important step of an M&A investment. The acquiring firm may overpay for the target if it is uncertain about the target's true stand-alone value. On the other hand, if the acquiring firm gets a better picture of the target's business, it may be better able to estimate the potential

synergies or benefits that could be generated through an M&A.

When MNCs undertake cross-border M&As in Asian countries, they may probably encounter more difficulties to access enough information about the target firms, than in the case of a domestic acquisition. First, as they expand abroad, they inevitably face the “liabilities of foreignness” (Hymer, 1976). It probably takes more time for the MNCs to better understand the local business environment, than a local business firm. It also requires that the managers of the acquiring firm dedicate more time and effort to looking for a suitable target. Further, most Asian countries are characterized with serious information asymmetry, which indicates that outsiders can hardly obtain a free flow of largely accurate information about companies. Given that, capital markets in developing Asian countries are lack of well-functioning institution mechanisms such as “reliable financial reporting system, a dynamic community of analysts, and an aggressive, independent financial press” (Khanna & Palepu, 1997: 43).

Therefore, acquirer’s knowledge about the target firm is of particular significance when an MNC undertakes a cross-border M&A in Asia. One strategy to overcome this information disadvantage is to become involved in the company through a small equity stake (Kang, 1993). If the acquirer holds the target shares before the acquisition, it could save a much time, effort and money for the acquiring firm to collect the relevant data of the target. Acquirer’s knowledge about the target firm that accompanies this small ownership could facilitate the acquirer to assess more accurately the true value of the target and the potential benefits of the merger, and then to make the right decision.

In summary, I expect acquirer’s knowledge about the target firm prior to the acquisition could reduce the searching cost and facilitate the target’s valuation, which

in turn enhances the net present value of the M&A investment.

Hypothesis 4: Acquirer performance is positively related to the level of the acquirer's knowledge about the target firm prior to the acquisition.

3.2.2 Prior organizational acquisition experience

Execution of an M&A investment is a complicated process which absorbs significant amounts of managerial energy and time (Hitt, Hoskisson & Ireland, 1990). Acquiring firms need to conduct extensive data collection and analysis to find viable acquisition candidates. When the target is set, the time-consuming negotiations begin. As the negotiations would directly determine how much premium the acquirer will pay and whether the acquirer is able to get a good deal, this process demands much attention and energy from the executives of the acquiring firm. Further, once the deal is made, the post-acquisition integration brings along another great challenge to the executives of the acquiring firm.

According to the learning curve literature, firms could become more proficient at managing particular kinds of complicated organizational activities such as an acquisition, as they have more and more experience in undertaking such activities (Cyert & March, 1963). Haleblan & Finkelstein (1999) argue that good firm performance is more likely to persist and strengthen, while poor performance leads to behavioral diminution, just consistent with the behavioral principal – “rewarded” behavior to persist and “punished” behavior to diminish. From this perspective, firms that have undertaken M&As in the past will be more sophisticated in managing M&As and in extracting the benefits while simultaneously avoiding the pitfalls of

M&As.

Therefore, I predict that with the accumulation of organizational acquisition experience, acquiring firms are able to manage the M&A investments more proficiently, which thereby could enhance their performance.

Hypothesis 5: Acquirer performance is positively related to its prior experience in undertaking M&A activities.

3.3 Summary

In summary, the net present value of an M&A transaction will be affected by the expected value creation and the estimated cost of this acquisition investment. Firm-specific ownership advantages can provide the acquirer with a superior competitive position in foreign markets, which in turn positively influence its stock market performance. Both related and unrelated M&As have the potential to generate gains to the acquiring firms. Furthermore, I suspect an acquirer possessing superior ownership advantages will exhibit better performance when it undertakes related M&As.

When looking into the investment cost side, I expect the performance of the acquiring firms would be positively related to the extent of acquirer's knowledge about the target firm, and its prior M&A experience.

CHAPTER 4 RESEARCH DESIGN

In this chapter, I discuss the research design used to test the hypotheses proposed in the previous chapter. I examine the hypotheses by analyzing a sample of 314 M&A transactions undertaken in 11 Asian countries during the period of 1985-1999. I provide my description of the regression model and the variable measures in the following paragraphs. I begin with a description of the setting, and the data.

4.1 Setting

I choose cross-border M&As undertaken during 1985-1999 in Asia as my research focus. Compared with the dominant research studies on M&As in the developed economies (especially the U.S.), the Asian context has received scant attention. However, as the global business environment changes, firms outside Asia make strategic responses to defend and improve their competitive position by paying much more attention to Asia than ever before. Further, the intra-Asia business activities have also become more and more dynamic, with the remarkable economic development of many countries in this region. Therefore, studies on M&As undertaken in Asia can not only help inform the literature on acquisitions about a growing phenomenon, but provide some helpful implications to the practitioners as well.

4.2 Sample

I obtained the M&A transactions in my thesis from the Thomson Financial Database of “Worldwide Mergers & Acquisitions”. The “Worldwide Mergers & Acquisitions” database covers international M&A transactions from 1985 to the present. It provides

information about the company profile of the acquirer and target, deal value, deal status, stock premiums, acquisition techniques and percent acquired, and so forth.

Originally, the dataset comprised 729 cross-border M&A transactions of 464 acquiring firms. In my initial inspection, I identified 91 domestic transactions which I excluded from the original sample to make my study strictly focus on cross-border M&As. Further, as the information about Asian acquiring firms (from Hong Kong, and Singapore) after 1999 was not accessible, I excluded 150 transactions undertaken by U.S. firms after 1999 so that I can make reasonable cross-country comparisons using the same time periods. Finally, as my arguments and hypotheses developed in the previous chapters imply a focus on the major M&As in which the acquiring firms obtain the control right of the target firms after the transactions, I excluded 174 minor acquisition transactions where the acquiring firms obtained less than 50% shares of the target equity. These steps resulted in a sample of 314 cross-border M&A transactions completed during 1985-1999.

These 314 international transactions were made by 246 acquiring firms from the U.S., Hong Kong and Singapore. The U.S. firms seem to be the most active acquirer in my sample; more than half (60.83%) of the transactions were conducted by firms from the United States. Regarding the Asian acquirers, Hong Kong and Singapore firms completed 62 and 61 deals respectively during the period of 1985 - 1999.

Looking into the years when these international M&As happened, I find two interesting observations. Firstly, there is an obvious increase in the M&A activities in this region after 1996. 57.01% of the total investment was conducted among the three years from 1997 to 1999. This is probably due to the economic crisis that occurred in 1997. During the crisis, asset values collapsed and many assets that were previously inaccessible or difficult to acquire, became available and affordable (Singh & Yip,

2000). No matter whether firms are purely interested in bargain hunting, or they are seeking for investment opportunities for long-term performance, the Asian crisis brought them potentially attractive purchases.

Taking a closer look, we can find another interesting phenomenon: most of the transactions after 1997 were contributed by U.S. firms. About two-thirds of the total 125 transactions that occurred between 1998 and 1999 were conducted by U.S. firms. This is understandable since other Asian acquirers might be more or less be negatively impacted by the crisis in terms of the currency depreciation and the deterioration of the business environment in their countries.

On the target side, the 314 transactions cover 11 Asian countries, of which China, Hong Kong, Malaysia, and Singapore had aggregately received 69.11% of the total investment. Interestingly, the number of international M&A transactions conducted in South Korea in the year of 1998 amounts to the aggregate of all the transactions that had been completed in this country in the previous 10 years. A major explanation to this evidence is that the Korean government adopted the policies to open its capital market after the crisis. The government even abolished restrictions on foreign ownership of land (Chung & Wang, 2001).

These cross-border M&A transactions involve target firms operating in 50 2-digit SIC industries. The most common sectors were electronic equipment (9.55%), business services (8.28%), chemical products (8.28%), durable wholesale trade, (7.96%), and food product (5.73%). A similar distribution applies to the acquiring firms from 46 different 2-digit SIC sectors.

Furthermore, I also looked into the cross-distribution by the industries and target nations over the entire sample and each subsample (Hong Kong, Singapore, and U.S.) as well. (Table 4-1, 4-2, 4-3, 4-4, 4-5) Continuing with the previous analysis, we can

further find that in the most common sector - electronic equipment, 40% of the investment in this sector took place in Hong Kong, and 20% in South Korea. Similarly, the deals completed in printing, chemical product, wholesale trade of durable goods, real estate, and business service industries are not equally distributed across the 11 target nations either. All of the 8 transactions in printing, publishing and allied industries were undertaken in Hong Kong. In chemical product sectors, China and South Korea aggregately received nearly half (46.2%) of the investment. Among the total 11 Asian countries, Hong Kong and Malaysia are the most popular targets for foreign direct investment in the wholesale trade of durable goods. Seven of the 13 transactions in real estate sector were conducted in China; for the business service sector, Hong Kong, Singapore, and China were the top three most popular target markets.

In addition to the entire sample, I also investigate into each subsample based on the three country origins of acquiring firms. First, 77.4% of the Hong Kong acquiring firms took over a target firm in China, largely in China's manufacturing, finance and service industries. Second, Malaysia is the most popular FDI destination countries for Singapore acquirers; 39.34% of the acquisitions by Singapore firms occurred in Malaysia. Singapore acquiring firms are more interested investing in the finance and service industries of the Malaysia and China markets. Third, compared with their Asian counterpart, U.S. acquirers focus much more on M&As in the manufacturing industries: about 54.97% of the total investment by U.S. acquiring firms went into the manufacturing sector. In contrast, only 34.15% of the acquirers from the two Asian countries were involved in an M&A in the manufacturing industries, but 39.02% in finance and business service. These figures are much higher than the corresponding level of 18.32% in the U.S. group.

Regarding the relatedness between the acquiring firms and target firms, in about 64.33 percent of the transactions included in my sample, acquiring and target firms are operating in related industry sectors based on the business descriptions of the 4-digit SIC codes, whereas 35.67 percent of the transactions in my sample are cross-border M&As in which acquiring firms come from unrelated sectors with the target firms at 4-digit SIC level.

Doing a cross-country comparison, I find in my sample, that the Asia subsample (firms from Hong Kong and Singapore) seems to be a mix of related and unrelated M&As, while the U.S. acquiring firms are much more likely to undertake related M&As, with a frequency of nearly three times that of unrelated ones. From the perspective of target nations, on the other hand, 43 out of the 112 unrelated M&A deals flowed into China. Since one of the major motivations for an unrelated M&A is to smooth the variance in cash flow and to eventually diversify the risks, it is reasonable to find that a considerable proportion of the acquiring firms in my study choose to invest in China, a country with remarkable economic growth during the past decade.

4.3 Model and measures

As discussed in Chapter 2.2, two major approaches have been applied in the contemporary research on M&As: outcome studies and event studies. Industrial organization economists use outcome studies to compare the pre- and post-acquisition performance and to compare the merging firms with matching firms or the base industry. This approach would be particularly valuable if the acquisition is the only major strategic event in the firm in a year. However, if there are many other

contributors to the acquirer performance in the same period, it would be difficult to conclude whether any change in acquirer performance is singularly due to the M&A strategy or not. Since the information disclosed on the financial statements reflects how well the whole business operations perform over a certain fiscal period, such accounting data would include information about many events which occur during the same period. Therefore, the accounting data does not reflect the exclusive outcome of an M&A activity.

In addition, problems may also occur when using the outcome studies to compare acquirer performance with a control group of similar firms. As I am studying on the cross-border M&As undertaken by acquiring firms from 3 different countries and across various industry sectors, it is difficult to establish a control group of firms with similar size and industrial roots but not involved in M&As.

It is because of the limitations of the accounting approach discussed above, that I use the other accepted methodology, event studies, to examine the influence of an acquisition on the acquirer performance. Event studies examine the performance effect by evaluating the impact of a particular type of event on the stock prices of the affected firms.

My selection of this methodology is based on an implicit assumption that the capital markets of U.S., Hong Kong and Singapore are efficient. The country origins of acquiring firms in my study comprise the United States, Hong Kong and Singapore. According to one study by World Bank, the overall development of the stock markets of these three countries was ranked at 2nd (Hong Kong), 4th (the United States) and 7th (Singapore) respectively (World Bank, 1995). In these economies, the capital market is characterized by strong regulation, reliable financial reporting, best practices, high liquidity, and excellent access to foreign institutional buyers (Pangarkar & Junius,

2004; Khanna & Palepu, 1997). For example, the World Bank Study indicates Hong Kong and U.S. stock markets are characterized with high liquidity as the total value of shares traded on the stock exchanges are greater than 40% of GDP; the United States has low mis-pricing values; the market of Singapore measured by indexes is more “developed” than France, Netherlands and Sweden. Therefore, I believe such characteristics can reasonably justify the adoption of an event study approach to examine the performance of acquiring firms from these three regions.

I conducted statistical analysis to investigate the determinants of acquirer performance. The regression model which I constructed to test my hypotheses is presented as below:

$$CAR = \beta_1 OA + \beta_2 REL + \beta_3 INTERACT + \beta_4 KNOWLEDGE + \beta_5 EXP + \beta_6 EXP^2 + \beta_7 PAY + \beta_8 NEGO + \beta_9 SIZE + \beta_{10} CASHFLOW + \beta_{11} LIABILITIES + \beta_{12} PROFITABILITY + \beta_{13} YEARDUMMY + \beta_{14} TGT DUMMY + \mu$$

The descriptive statistics of the measures used in this thesis is provided in Table 4-8 attached at the end of this chapter.

4.3.1 Cumulative abnormal returns

Except for the U.S. subsample in which cumulative abnormal returns (*CARs*) are obtained directly from the EventUs on the website of Wharton Research Database Center, I manually calculate the *CARs* for all the acquiring firms from Hong Kong and Singapore. I adopt the market model to present the return-generating process,

$$R_{it} = \alpha_i + \beta_i R_{mt}$$

where $R_{i,t}$ = daily return for firm i over day t ;

R_{mt} = the return on the market portfolio over day t

Then I use the OLS procedure to estimate the model parameters based on the period

from 300 days before till 30 days after the event announcement. After obtaining the $\hat{\alpha}_i$, and $\hat{\beta}_i$, I calculate the daily abnormal return over the period t-20 to t+1 days for each security. I also applied other different event windows.

$$AR_{it} = R_{it} - \hat{\alpha}_i - \hat{\beta}_i R_{mt}, (t=-20 \text{ to } t=+1)$$

Finally, I obtained cumulative abnormal returns for each security by aggregating the daily abnormal returns over the event period:

$$CAR_i = \sum_{t=-20}^{t=+1} AR_{it}$$

Both short and long-term event windows have been applied in the existing research of M&A performance. Andrade et al. (2001, page 113) have outlined several major concerns with the long-horizon window approach. For example, they pointed out that one of the basic concerns “stems from all tests of long-term abnormal performance being joint tests of stock market efficiency and a model of market equilibrium”. Compared with the zero expected returns in a short window, the expected returns for a three-year window could easily vary with the model used. That is, the expected returns in the long term window can only be roughly estimated, which in turn questions the preciseness of the estimates of long-term abnormal returns. Further, researchers also challenge the assumption for long-horizon event studies that abnormal returns are independent across firms. Over a long time period, major corporate activities such as M&As might not be random events; M&As could cluster through time by industry (Andrade et al. 2001).

In addition to the limitations of statistical reliability discussed above, a long-horizon window might also capture many other events than the acquisition which happen within the same period. In this sense, the CARs will not specifically reflect the market expectation on the performance impact of an M&A activity.

Given the above concerns with the long-horizon event studies, I use a short event window to examine the prompt market response to the event of M&A. In efficient capital markets, stock prices should quickly adjust upon the announcement of M&As, incorporating any expected value creation or destruction (Andrade et al., 2001).

I answer my first research question, “whether acquiring firms win or lose from cross-border M&As in Asia” by testing the null hypothesis of zero cumulative abnormal return at the time period from t_1 to t_2 , for the entire sample and each subsample. I test the statistic significance of Patell Z scores.

The cumulative abnormal return for each security is used as the dependent variable when I run the above regression model to investigate the factors that would influence acquirer performance.

4.3.2 Ownership advantages

As the information of R&D and advertising expenses are not attainable for Asian acquiring firms, I use intangible assets (*IA*) to measure acquiring firms’ ownership advantages for the test of the entire sample. According to the Financial Reporting Standard, companies are required to disclose the value of their intangible assets in the balance sheet. Intangible assets in accounting terms refer to the identifiable non-monetary assets without physical substance. Common examples of intangible assets are patents, copyrights, licenses, brand names and publishing titles, etc. To deal with heteroskedasticity problems, I scale the intangible assets by total assets (*TA*). Therefore, I have IA/TA as the proxy for acquiring firm’s ownership advantages.

For the subsample of U.S. acquiring firms, I also use R&D expense intensity (RD/TA) and advertising expense intensity (ADV/TA) as the proxy for ownership

advantages to test my hypothesis 1.

I obtained the relevant information about acquiring firms' intangible assets from CRSP and Worldscope (for U.S. firms). The database of PACAP provides information about the acquiring firms from Hong Kong and Singapore.

4.3.3 Business relatedness between acquiring and target firm

The Thomson Financial Database of “Worldwide Mergers & Acquisitions” on the SDC Platinum provides information about the primary industry code of both acquiring and target firm. I use the business description of the 4-digit level SIC code to identify whether the core business of an acquiring firm is related to that of the target firm (Davis & Duhaime, 1992). In fact, I derived three sets of measures for the business relatedness. First, I only create two groups, one for *RELATED*, the other for *UNRELATED*, based on the detailed business description of the 4-dig SIC. Second, I divide the *RELATED* ones in the first set into two subgroups: *HORIZONTAL* and *VERTICAL* related M&As. Third, I further subcategorize the related group into six different types: *SAME BUSINESS*, *SIMILAR PRODUCTION*, *SIMILAR CUSTOMER*, *SIMILAR TECHNOLOGY*, *UPWARD VERTICAL*, and *DOWNWARD VERTICAL*.

4.3.4 Interaction between ownership advantages and business relatedness

To examine the performance effect of interaction between ownership advantages and business relatedness, I derive the variable, *INTERACT*, by multiplying the “ownership advantage” variable by the “relatedness” dummy variable as described below:

$$\begin{aligned}
INTERACT_1 &= (IA/TA) * (RELATED) \\
INTERACT_2 &= (RD/TA) * (RELATED) \\
INTERACT_3 &= (ADV/TA) * (RELATED)
\end{aligned}$$

INTERACT_1 is used to test hypothesis 3 for the entire sample and the Asian and U.S. subsamples as well. *INTERACT_2* and *INTERACT_3* are only applied to the test on U.S. acquiring firms.

4.3.5 Acquirer’s knowledge about target firm

Knowledge about target can be measured as whether the acquiring firm holds any shares of the target firm prior to the announcement of the M&A. The ownership of target equity provides the acquirer a better access to the information of the target firm.

The SDC Platinum provides information about the percentage of shares owned by the acquiring firms prior to the announcement of the M&A. So I use a set of dummy variables *KNOWLEDGE*, to indicate the extent that acquiring firm has information about the target firm. *KNOWLEDGE_1* is coded as 1 if the acquirer holds any share of the target firm, otherwise it is coded as 0. *KNOWLEDGE_2* is coded as 1 if the acquirer holds more than 10%, otherwise it is coded as 0.

4.3.6 Prior acquisition experience

Prior M&A experience (*EXP*) is measured in four ways. I construct the first “experience” variable, (*EXP_1*) by counting the number of cross-border M&As undertaken in Asia by the acquirer prior to the focal transaction. A squared term of this variable (*EXP_1_2*) is included to examine the potential curvilinear relationship between M&A experience and acquirer performance.

I introduce the logarithm of the number of cross-border M&As undertaken previously (*EXP_2*) as the second measure for acquisition experience. A squared term for this variable (*EXP_2_2*) is also used to capture the possible curvilinear relationship.

The third way to measure prior M&A experience is to take the logarithm of the length of time between the focal transaction and the first transaction by the acquirer. By *EXP_3*, the length of experience is measured by month; similarly, by *EXP_4*, the length of experience is measured by year.

I also introduce a dummy variable, *EXP_5*, to measure the prior acquisition experience. It is coded as 1 if the acquirer has any cross-border M&A activity undertaken in Asia before the focal transaction; otherwise it is coded as 0. I can use this variable to compare it with the results from using other variables of M&A experience, and to see whether the intensity of experience (in terms of length), or the presence of experience (in terms of yes or no), or both have a significant effect on acquirer performance in M&A transactions.

4.3.7 Control variables

I include six control variables in my regression model. The variable, *SIZE*, is calculated as the logarithm of total assets of the acquirer. *PAY* is a dummy variable to show whether the deal is paid by cash (1=stock, 0=otherwise). The dummy variable, *NEGO*, is coded as 1 if the transaction is completed by private negotiations; otherwise it is coded as 0. In addition, I use the variable, *CASH FLOW*, to control the effect of cash constraints. Another variable, *LIABILITIES*, is established by dividing the total long term loan by the total assets. The acquirer's pre-acquisition *PROFITABILITY* is

also adopted as control variable. Finally, I include the year dummies and country dummies to capture the potential impact of specific time period and the impact of target nations. I obtain most of the information on which these variables from SDC Platinum, with an addition of supplementary information, where required, from CRSP and PACAP.

CHAPTER 5 RESULTS

In the introduction chapter, I introduced two research questions for this thesis: 1) whether acquiring firms win or lose in the cross-border M&As in Asia? 2) What are the influential factors on acquirer performance? Accordingly, chapter 3 develops a conceptual model and relevant hypotheses for my thesis, and chapter 4 describes the sample and variable measures for testing in this study. In this chapter, I try to answer the two research questions by reporting the results for a Patell Z test on cumulative abnormal returns to the acquiring firms in my study, and the results for OLS regressions on the model developed in chapter 3. I not only provide results for the test on the entire sample, but also report the results for tests on each subsample which is divided according to the country origins of acquiring firms. I will discuss the findings in chapter 6.

5.1 Acquirer performance

In the previous chapter, I described the event study methodology to examine firms' market performance in their M&A activities. Under the null hypothesis of zero cumulative abnormal returns at the time period from *Day-20* to *Day+1*, I test the statistic significance of Patell Z scores for the entire sample and each subsample.

5.1.1 Z test on the entire sample

For the entire sample of 314 cross-border M&As by 246 acquiring firms, the average cumulative abnormal returns to the acquirers are 0.48 percent, with a z-score of 1.17. It shows that acquiring firms earn insignificant abnormal returns from cross-border

M&As in Asia. In other words, the shareholders of the acquiring firms do not experience significant wealth improvements or wealth destruction in M&As in Asia. This result is consistent with the findings by Koh & Lee (1988), and Ding et al. (1996). In their study, Ding et al. report an excess return of 0.66 percent, with a t-value of 0.78.

5.1.2 Z test on subsamples

I construct 4 subsamples according to the country origins of the acquiring firms: M&As by Hong Kong acquirers; M&As by Singapore acquirers; M&As by U.S. acquirers; and M&As by Asian acquirers (combined with Hong Kong and Singapore acquirers). Table 5-1 provides the average cumulative abnormal returns (ACARs) and z-scores for each subsample.

We observe that only the U.S. acquirers earn significant, but small positive excess returns; but no significant abnormal returns are found among Asia acquirers. The results on U.S. part are consistent with Chari, et al. (2004)'s finding of significant abnormal returns of 1.65 percent.

5.2 Influential factors of acquirer performance

I run OLS regressions on the empirical model set up in previous chapters. As I have developed three alternative sets of measures for business relatedness, I make three groups of tests respectively, by changing the measures for relatedness. Further, I not only test my hypotheses on the entire sample, but also run regressions on Asia and U.S. subsamples as well.

5.2.1 Findings on entire sample

Table 5-2 displays the results for the tests of all hypotheses on the entire sample. Model 1 uses a binary dummy to indicate business relatedness; in Model 2, relatedness is categorized into 3 different groups: unrelated, horizontal related, and vertical related; Model 3 then provides a more detailed division of business relatedness. The signs and significance of the coefficient estimates are mostly consistent across these 3 models.

Hypothesis 1 predicted that an acquiring firm with superior ownership advantages would experience better performance through M&As. The positive and significant ($p < 0.05$) coefficient estimates on the intangible intensity provides support to this hypothesis. I will discuss these results in more detail in the next chapter.

Hypothesis 2 made predictions on the relationship between business relatedness and acquirer performance. I find statistically significant results to support the hypothesis. The positive signs on the measures for relatedness are consistent in Model 1-3. The regression results indicate that horizontal M&As, especially those sharing similar technology are expected to generate more benefits to acquiring firms.

Hypothesis 3 predicted that an acquiring firm with superior ownership advantages could exhibit better performance if it undertakes a related M&As. However, the coefficient estimate on the interaction effect between relatedness and intangible intensity is significantly ($p < 0.05$) negative, which is opposite to my original prediction. Such a negative sign indicates that intangible asset intensity has a less positive, instead of a more positive effect on acquirer performance in a related M&A.

Hypothesis 4 predicted a positive relationship between acquirer performance and acquirer's knowledge about the target firm. However, the regression findings do not

support this hypothesis as the relevant coefficient estimate is not significant from zero.

Hypothesis 5 predicted that acquiring firms could exhibit better performance as they accumulate more organizational acquisition experience. Model 1-3 consistently show a significant ($p < 0.01$) U-shape curve of the relationship between acquisition experience and acquirer performance. Such a curvilinear relationship indicates that acquirer performance would first decline and later increase with the firm's organizational acquisition experience.

As for the effects of control variables, first, I find that although the coefficient estimate on payment mode is negative, it is not statistically significant, thereby providing no support for the argument that acquirers would suffer subnormal returns if they pay the deal by stocks instead of by cash. Second, no evidence exists for the idea that private negotiations in an M&A transactions could improve acquirer performance. Third, the significantly ($p < 0.10$) negative coefficient estimate on acquirer size shows that the acquirer performance would be better as acquirer firm size decreases. Fourth, the coefficient estimate on cash flow is not statistically significant, providing no support for Jensen's free-cash-flow theory. Fifth, a similar situation also applies to the effect of liabilities. The presence of an insignificantly positive coefficient estimate on the liabilities does not support the argument that loans by financial institutions could better monitor the acquiring firms and thereby improve their performance in M&As. Sixth, the acquirer's pre-acquisition profitability is found to be significantly ($p < 0.10$) and positively related to its market performance in M&As. Seventh, acquisitions conducted in the year of 1988 appear to suffer subnormal returns for the acquiring firms. Finally, the results show that acquirers taking over Hong Kong, China and Indonesia firms enjoy more benefits from the acquisition.

5.2.2 Findings on Asia acquirers

Table 5-3 displays the findings of tests on the subsample of cross-border M&As undertaken by Asian acquirers, including M&As by Hong Kong and Singapore acquiring firms. Similarly, three different sets of measures were used to test the hypothesis on business relatedness, and the results are presented in Models 4-6 of Table 5-3.

Comparing the results with the findings on entire sample, we note that most of the coefficient estimates for tests on Asia acquiring firms become statistically insignificant, except for the effect of business relatedness.

First, the effect of ownership advantages and its interaction with relatedness become insignificant in the tests on Asia acquirers. When I run a regression on the entire sample, I find that ownership advantages measured by intangible assets is significantly ($p < 0.05$) positively related to acquirer performance, and its interaction with business relatedness has a significantly ($p < 0.01$) negative effect on acquirer performance. However, in the subsample of Asia acquirers, these effects become insignificant, although their signs remain the same.

Second, as the coefficient estimate on acquirer's knowledge about target firms is insignificant in tests on the entire sample, I still do not find in the Asia subsample either supportive or contradictory evidence for the relationship between acquirer performance and its knowledge about target firms.

Third, in the entire sample, I find a significant U-shape curve of the relationship between acquisition experience and acquirer performance. However, this curvilinear relationship disappears in the subsample of Asia acquirers. I do not find significant evidence of relationship between the acquisition experience and acquirer performance.

Last, only the positive estimates on relatedness variables remain statistically significant in the subsample of Asian acquirers. The regression results show that Asian acquirers would enjoy abnormal returns by taking over target firms in related lines, especially when the acquiring and target firms are involved in the same business sectors or share similar production.

5.2.3 Findings on U.S. acquirers

Table 5-4 and Table 5-5 display the findings of tests on the U.S. subsample, with ownership advantages measured by intangible assets and R&D / advertising expenditures respectively. Similarly, I also use different sets of measures for business relatedness.

When I use intangible assets to measure ownership advantages, I only find a significantly positive coefficient estimate on the squared term of the variable of prior M&A experience. When using R&D / advertising expenditures to measure ownership advantages, I find the following significant results: first, a significantly negative, instead of positive coefficient estimate on the R&D expenditure ($p < 0.05$). Second, related M&As appear to be destructive to the acquirer performance ($p < 0.05$). More specifically, I find that shareholders of acquiring firms tend to suffer wealth loss if the firm takes over a target firm which shares similar production, or when the firm acquires its supplier in Asia.

Third, I find a significantly positive effect of the interaction between R&D expenditure and business relatedness ($p < 0.05$). This result supports my hypothesis 3, but contradicts the finding on the entire sample whereby ownership advantages are measured by intangible assets. In Chapter 6, I will discuss the findings in more details

Fourth, consistent with the findings on the entire sample, the significantly positive coefficient estimate on the square term of prior M&A experience indicates a U-shape relationship between the acquirer performance and organizational M&A experience. I also replace the logarithm measure by using the untransformed term (number of M&As); however, I do not find any significant results.

5.3 Summary

In summary, I use the Patell Z test to investigate whether acquiring firms win or lose from their cross-border M&As in Asia, and run OLS regressions to test the hypotheses about the influential factors of acquirer performance.

Patell Z tests show that on average, acquirers earn insignificant abnormal returns from cross-border M&As in Asia. Further, the results for tests on subsamples show that only the U.S. acquirers enjoy significantly positive returns of 1.12 percent; acquiring firms from Hong Kong and Singapore neither win nor lose significantly from M&As.

A summary of the hypotheses and empirical findings is listed in Table 5-6. The results for OLS regressions on the entire sample provide support for hypothesis 1 about the positive effect of intangible assets. I also find a significant U-shape relationship between acquisition experience and acquirer performance (Hypothesis 5).

Regression results for the entire sample also show that related M&As are expected to generate more benefits for acquiring firms (Hypothesis 2). However, the regression findings are contradictory to my original expectation on the interaction between ownership advantage and relatedness (Hypothesis 3), that I find the positive relationship between intangible assets and acquirer performance would be weakened

in related M&As. Finally, I do not find a significant effect of acquirer's knowledge about the target firm on the acquirer performance. I will discuss these findings in more details in the next chapter.

CHAPTER 6 DISCUSSION & CONCLUSION

This thesis examines the market performance of acquiring firms in cross-border M&A activities in Asia. I present a set of influential factors of acquirer performance by identifying not only the elements influencing the benefits generated through M&As, but also the factors that determine the cost of M&A investments. By using a sample of 314 acquisition transactions by 246 acquiring firms in 11 Asian countries, I test five hypotheses regarding acquirer performance utilizing an OLS regression model.

The results support several of the hypotheses. The results show that an acquiring firm with superior intangible assets would exhibit better performance in M&As. When a firm undertakes an related M&A, the acquirer is expected to enjoy better performance. The data also reveal a U-shape relationship between acquisition experience and acquirer performance. The cumulative abnormal returns to the acquiring firm first decline and later increase with the accumulation of organizational acquisition experience.

However, the study does not provide support for the hypotheses on the effect of interaction between intangible assets and relatedness and the effect of acquirer's knowledge about target firm. The significantly negative sign on the interaction effect between relatedness and intangible assets is contradictory to my hypothesis 3 which predicted that undertaking a related M&A would strengthen the positive effect of intangible assets on acquirer performance. In addition, regressions do not find significant effect of acquirer's holding of target's equity prior to an M&A.

In the following sections, I analyze these findings in more details, and I complete this thesis by discussing its limitations and future research direction.

6.1 Ownership advantage & its interaction with business relatedness

According to the Resource-based view and Foreign Direct Investment theories, through cross-border M&As, acquiring firms are able to exploit their specific ownership advantages over a larger scale and over a different geographic market, thereby enjoying better market performance. Furthermore, ownership advantages normally take the forms of superior technological know-how, marketing know-how, and management know-how. Such superior knowledge or resources are more specific to the businesses in which a firm is involved. That is, ownership advantages should be more easily transferred within related M&As rather than within unrelated ones. Therefore, I expected there would be a positive relationship between ownership advantages and acquirer performance (Hypothesis 1), and such a relationship would be strengthened if the acquirer is conducting a related M&A (Hypothesis 3).

The OLS regressions provide mixing findings for the above hypotheses. The empirical tests show supportive evidence of the positive impact of intangible assets on the acquirer performance. But such a positive relationship is found to be weakened, instead of being strengthened, within a related M&A. In order to understand this unexpected finding, we need to take the following two factors into consideration: 1) the definition of intangible assets; and 2) the interaction between acquirer's intangible assets and the target's.

First, in this study, ownership advantages are measured by intangible assets which are disclosed in the company's balance sheet. According to the Financial Reporting Standard, intangible assets are the identifiable non-monetary assets controlled by the firm, which could generate future economic benefits. Common examples of intangible assets are patents, licenses, copyrights, brand names, publishing titles and etc. It indicates the overall superior resources that a firm

specifically possesses.

Second, after clarifying the definition of intangible assets, let us look into its interaction with business relatedness. I develop my hypothesis 3 by focusing on the acquirer characteristics. However, M&A is a business activity with two parties involved, both the acquirer and target firm. The contribution of acquirer's intangible assets differs when the acquiring firm is engaged in different relationship with the target.

In related M&As, acquiring firms normally share similar technology, production, or markets with the target firms. Consequently, there probably are overlaps in their resources, including the intangible assets after the acquisitions. In this sense, the combination of intangible assets post acquisition would be less than the sum of their stand-alone intangible assets prior to acquisition.

For instance, in many cases of related M&As, the brand(s) of one merging firm would be withdrawn from the markets, which directly influence the re-valuation of the intangible assets for this firm. Therefore, for the acquiring firms undertaking related M&As, their intangible assets are likely to be revaluated downwards; that is, the contribution of the acquirer's intangible assets on its acquisition performance would be weakened in related M&As.

In contrast, in unrelated M&As, the acquirer's intangible assets tend to increase in value or at least remain the same. As the acquiring and target firms are operating in different businesses, their intangible assets would not offset each other's due to post-acquisition overlaps. The acquirer's intangible assets would at least not be devalued. Further, there might be an amplifying reputation effect through unrelated M&As in Asia countries.

Several of the Asian countries in this study are characterized by some level

institution voids for business operations. According to Khanna & Palepu (1997), most emerging markets suffer from under-developed communications infrastructure; besides, independent consumer-information organizations and consumer redress mechanisms are not in place as well. As a result, much higher costs would be induced to build up credible brands in such markets. Under such circumstances, MNCs with an established reputation would especially enjoy a strong advantage. This reasoning is consistent with my finding that acquiring firms with more intangible assets are expected to outperform those with less intangible assets through cross-border M&As in Asia.

In line with the above, the acquirer's established reputation could be leveraged over a larger scale and scope in an unrelated acquisition. Under such a circumstance, the firm has a greater incentive not to damage its reputation in any of its businesses because reputation damage in one business would also impact its other businesses (Khanna & Palepu, 1997). These two factors could be mutually reinforced. As a result, the market would anticipate an upward valuation of the acquirer's intangible assets in unrelated M&As, which means the effect of intangible assets on acquirer performance is amplified in unrelated M&As.

In the following paragraphs, I discuss the limitations of the measure of intangible assets. As in the accounting terms, intangible assets can be accounted only if the assets meet the definition and recognition criteria. For example, according to the accounting definition, intangible assets must be under the entity's control. Specific management or technical talent is unlikely to meet the definition, although they are considered to be ownership advantages. Similarly, a firm may have a portfolio of customers or market shares which are expected to continue to trade with the firm. But customer relationship or loyalty would not be accounted for intangible assets if there

is insufficient control over the expected benefits from such a relationship or loyalty. As a result of such differences between the accounting definition and the strategic perspective on intangible assets, ownership advantages might be understated by using the accounting measure of intangible assets.

Second, the accounting measure of intangible assets indicates the overall superior resources or assets that a firm could leverage, regardless of business relatedness. It does not distinguish different types of ownership advantages, i.e. technical knowledge, marketing knowledge or management knowledge. To understand the effect of different types of ownership advantages, there is a need to develop more specific measures for the specific advantages. In the existing research, R&D expenditures and advertising expenditures are the most common gauges used to measure technical know-how and marketing knowledge. Unfortunately, information about R&D and advertising expenditures for the Asian acquirers in my study is not attainable. Therefore, for the entire sample, I just use accounting intangible assets to measure the ownership advantages.

For the subsample of U.S acquirers, I run additional regressions by using the R&D and advertising expenditures, since the relevant data is available. However, the regression findings are contradictory to my expectation. I find that R&D expenditure per se is negatively related to the performance of U.S. acquirers; but its interaction with business relatedness has a significantly positive impact on the acquirer performance. Possible explanations could be as follows.

R&D expenditure indicates the effort that a firm has contributed to research and development activities; it could imply the importance of technical know-how in a firm. We may interpret higher R&D expenditure as indicating a firm values technological development more; it could be a more technology-oriented firm. If this is true, it

would be understandable that the market does not anticipate better performance for such a firm to expand its business into Asian markets. Why do the Asian markets attract FDI? The most likely answers might be low labor cost and the promising consumer market. From this perspective, firms rooted in mature or declining industries may consider transferring their production lines to Asian countries where the labor cost is much lower and where they expect to expand into a new market. Under such circumstances, high technologies might not be the most important resources for the acquiring firm to leverage. In other words, if the acquiring firm has superior technical strength, its expansion into an Asian market is not expected to be consistent with its core business strategy. Further, the lack of research infrastructure and poor protection of intellectual properties can be destructive to research and development activities in Asian countries.

However, if we consider the interaction between R&D expenditure and business relatedness, I find that the negative effect of R&D expenditure would be mitigated if the acquirer takes over a related target firm. This is explainable if we consider a related M&A as a basis for the combination of the merging firms' resources. The acquiring firm not only has its superior technical knowledge, but is also able to leverage on the target firm's productive resources and customer relationships. If the acquiring firm is undertaking an unrelated M&As, there is no basis for the acquirer to combine its superior technology with the target's production and marketing resources to generate operating benefits.

As discussed above, intangible assets are an overall indicator of a firm's superior ownership advantages. It is expected to be positively related to acquirer performance, but such a relationship could be weakened in unrelated M&As. For U.S acquirers, I also find that U.S. acquirers with superior R&D strength can enjoy better performance

only when they are involved in related M&As. Technical advantage per se is negatively related to acquirer performance.

6.2 Related and unrelated M&As

Whether related or unrelated M&As could generate abnormal returns to acquiring firms is another lively topic in the M&A literature. In this thesis, I try to answer this question by investigating the effect of business relatedness on acquirer performance. I find in my entire sample and Asian subsample, related M&As are expected to generate more economic gains for acquiring firms. However, for the U.S. acquirers, I find that shareholders of acquiring firms tend to lose from undertaking related M&As.

In order to explain the findings described above, here I introduce the concept of an organizational cultural effect in M&A activities. Post-acquisition integration is a challenging and critical process for the acquiring firm to eventually realize the potential benefits of an M&A, especially in related M&As. However, some researchers have argued that one difficulty in achieving operating synergies arises from “organizational inertia”. The generation of synergies in production, R&D, marketing, and management requires relevant operational and organizational changes. But “organizational inertia” might possibly prevent the focal firms, especially the acquiring firms, to make appropriate adjustments.

Further to this, Sirower (1997, page 40) points out that “the larger problems stem from the reshuffling of power and the unwritten expectations of payoffs of cooperating versus competing in the course of doing business in the new company”. Under such circumstances, effective communication would be especially important as it could help to reduce the uncertainty and ambiguity surrounding the acquisition

event; appropriate incentives and reward systems would also help to resolve the problem.

In this sense, it is reasonable to suspect that acquiring firms might encounter barriers in communicating core values and implementing core strategies during the post-acquisition phase. This difficulty might be most profound for U.S. acquirers as they might face more difficulties in the course of post-acquisition integration, compared with their Asian counterparts. This would in turn reduce the likelihood of realizing the operating benefits from related M&As.

On the other hand, potential benefits associated with unrelated M&As are relatively easier to be obtained. Financial resources are the major ones to be transferred within unrelated M&A to generate benefits. There are few constraints on the cash reallocation across the business units as these do not involve organizational changes, so financial synergies might be achieved with greater ease. Diversification of risk is realized once a cross-border unrelated M&A is completed. As a result, financial gains can be achieved with greater ease in an unrelated M&A than operating gains in a related M&A. Hence, from this perspective, we might be able to understand the negative relationship between relatedness and acquirer performance for U.S. acquiring firms.

With regards to the business relatedness, I would also like to discuss the relevant measures. In this thesis, I measure the business relatedness based on the analysis of detailed business descriptions of the 4-digit SIC codes (Davis & Duhaime, 1992). This approach has its advantages over the approach of directly comparing the 2-digit SIC codes.

First, by analyzing the detailed descriptions, we can avoid over-evaluating the relatedness. For example, certain 2-digit SIC categories cover a very broad range of

industry lines, and these lines might not necessarily be related to each other. With the approach of direct comparison of SIC codes, they would be improperly considered as related. In contrast, the detailed business descriptions of SIC codes could help us to filter out such incorrect cases.

By looking into the detailed business descriptions of SIC codes, we are better able to capture the potential relatedness between the businesses of the acquirer and target. For instance, in my thesis, I establish another two sets of measures for business relatedness in addition to the one of “related” vs. “unrelated”: I subcategorize the “related group” into 1) two subgroups: “horizontal” & “vertical”; or even more detailed, 2) six different types: same sector, similar production, similar customer, similar technology, upward-vertical, and downward-vertical. By doing this, we can especially capture the vertically related M&As, which could not be identified as related by comparing 2-digit SIC codes, as the 2-digit SIC codes for the firms involved in vertical M&As are definitely different from each other. The empirical tests on these two sets of measures for business relatedness show similar findings that the signs on all the relatedness measures are insignificantly positive.

6.3 Acquirer’s knowledge about target prior to the acquisition

Hypothesis 4 predicts that the more knowledge the acquiring firms have about the target firms prior to the acquisition, the better the performance the acquirers would enjoy through cross-border M&As. I use a dummy variable indicating whether the acquirer holds a portion of the target’s equity prior to the acquisition to measure acquirer’s knowledge about the target firm. Hence, a positive sign is expected to appear on the coefficient of such measure according to the hypothesis 4. However, the

finding in this study does not support this hypothesis as the coefficient estimate is not statistically significant.

In addition to the measure of pre-acquisition ownership, in future studies, we could consider some other measures for the understanding/information that acquiring firms have about the target. For example, besides the holding of target share, we could also look into the previous business relationship between the acquirer and target. If prior to the acquisition, the target is the supplier or buyer of the acquiring firm, then it would be likely that the acquirer possesses certain information about the target even though the acquirer might not hold any equity in the target firm. Such previous business history and relationship may facilitate the understanding of target's business, which in turn contributes to the acquirer performance through M&As.

6.4 Organizational acquisition experience

Hypothesis 5 argues that the performance of the acquiring firm in the cross-border M&As would increase as does the accumulation of its acquisition experience. I use various measures for acquisition experience (count of acquisitions, logarithm of the count number, and logarithm of the length of period between the focal acquisition and the first acquisition). The tests on the logarithm measures show a significant U-shape relationship between acquirer performance and acquisition experience but the untransformed measure does not work in the regression.

Using the measure of logarithm of acquisition number, we conclude that the acquirer performance would first decline with an increase in the number of acquisitions. This could be due to the great challenges presented in the critical integration process at the post-acquisition stage. Post-acquisition integration is a very

complicated process, which requires considerable management resources (time, money and effort). When a firm just starts its acquisition journey, the earliest acquisitions could present the firm with many challenges: it might encounter various pitfalls in different acquisition activities, and it might be short of management resources to cope with such problems, or too many resources would be diverted to the acquisition issues, which might affect the development or implementation of other important business strategies. As a result, it is possible that the acquirer performance declines at the early stage of its acquisition program.

However, as the accumulation of relevant experience exceeds a critical point, the acquiring firms might be able to benefit from their acquisition experience as they are more and more proficient in managing such business activities. They become to know how to keep the advantages while avoiding the pitfalls at the same time. The management resources could be better allocated and the business could be run in a more efficient and productive manner. Therefore, the performance of the acquiring firms would enhance with the accumulation of acquisition experience after a certain point.

The sample in this study includes all the M&A activities that the acquiring firms have undertaken in the Asian countries till year 1999. However, it is possible that the acquirers have conducted some other acquisitions in markets besides Asia. Therefore, it could be likely that the U.S. acquiring firms included in my sample have other exposure to the M&As in other markets. Such M&A experience could also be exploited when they conduct cross-border M&As in Asian context.

In future studies, we may also consider distinguishing the different phases of M&A activities in the different contexts. Many Asian firms could still be in their exploration stage of their acquisition journey; and therefore, they may need a longer

period to accumulate sufficient acquisition experience to overcome the downward phase. Taking into consideration the different status of M&A stories for the U.S. and Asian acquirers, we might find more insightful information about the effect of prior M&A experience on acquirer performance.

6.5 Limitations and future research directions

I try to contribute to the acquisition literature by enriching the theoretical framework for identifying the influential effects of acquirer performance, and by meeting the empirical needs of testing on the Asian context. That said, there are several limitations to my study which require further research attention and exploration.

Theoretically, the influential factors I have identified are not comprehensive. In this thesis, I propose a framework to identify the influential factors of acquirer performance by looking into the elements determining both the benefits and costs of acquisition activities. For this framework, I adopt perspectives from Internalization Theory, the Resource-based View, Industrial Organization Economics, Finance, and Learning Theory. However, the influential factors presented in this thesis are not a comprehensive list. We need further exploration to find other potential influential factors of acquirer performance.

One good way for future research to do this is to investigate the interaction between acquiring firms and target firms. M&As are business activities that require the engagement of two parties. Therefore, the role of both parties and their interaction could be crucial to acquisition performance. Unfortunately in this thesis, information about target Asian firms is rarely available; hence, I can only focus my analysis on the acquiring firms.

Another potential avenue for future research is to explore other potential reasons for M&As. In this thesis, I have discussed six driving forces for M&As: 1) market power, 2) operating efficiency, 3) financial benefits and 4) risk diversification, four of which are value-enhancing; and the non-value-enhancing reasons could be 5) hubris and 6) managerial discretion. However, there are reasons for cross-border M&As. For example, customer benefits may be one motivation for M&As. Firms may undertake M&As to jointly deliver products and services; as such integration through acquisitions is expected to attract more customers and in turn generate greater economic gains. In addition, some cross-border M&As in Asia, especially those shortly after 1997, may just be part of “rescue packages” in which the acquirers are willing or unwilling but “forced” to add capital to the target firm in order to enhance its liquidity. Identifying and understanding the specific reasons for M&As could help us to better analyze the acquirer performance and its determinants.

Empirically, data accessibility is the largest challenge to M&A research in Asian countries. Partly because of this fact, some of the measures adopted in this thesis are not ideal as discussed in the previous sections. In future research, we need to develop better information on Asian firms, and develop better measures to test for example, the effect of ownership advantages and acquirer’s knowledge about target.

Finally, mergers and acquisitions are an activity involving very complicated business processes, and M&A stories will vary in different firms. Therefore, we need other methodologies aside from event studies and an industrial economics approach to study this topic. Case studies could be a good tool to understand more about what is happening in individual M&As, and case studies might help us to identify other critical factors that can influence the performance of an M&A.

6.6 Conclusion

Few studies in the M&A literature have focused on the special context of Asia; I try to expand the empirical context for cross-border M&As research by testing five hypotheses about the influential factors of acquirer performance based on a sample of 314 cross-border M&As which were conducted in 11 Asian countries during 1985-1999. Further, I also try to enrich the list of influential factors of acquirer performance by providing a conceptual framework which identifies not only the factors that influence the potential value creation within M&As, but also the elements determining the total costs of M&A investments as well.

Academic research on mergers and acquisitions is just as intense and dynamic as the M&A activities undertaken in the business world. The M&A stories in Asia are receiving more and more attention. Further improvement based on the points mentioned in section 6.5, among others, will definitely help to provide more insights in the research field of M&A.

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