UNIVERSITI TEKNOLOGI MARA

EFFECTS AND DETERMINANTS OF CROSS-ORDER

MERGERS AND ACQUISITIONS (CBMAs) IN FIVE EAST ASIAN COUNTRIES

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ABSTRACT

Cross-border Mergers and acquisitions (CBMAs) form a large portion of foreign direct investment flows in developed world, and an increasing share in emerging markets especially to the Asian countries after Asian Financial Crisis in 1997/98. Various studies have been done on wealth effects and financial performance of firms in different countries and have yielded mixed results.

This study covers CBMAs in five Asian countries most affected by the Asian financial crisis namely, Malaysia, Thailand, Indonesia, the Philippines, and Korea. Malaysia reported the highest number of CBMAs but a rather low percentage of CBMAs in proportion to total M&As. The majority of the CBMAs in these countries were in the financial sector, followed by the industrial and material sectors.

Analysis on post-merger performance on a sample consisting of public listed firms with completed deals of more than ten percent of share acquisition by foreigners was performed using the event study method, key financial ratios and Tobin's q. From a sample of 94 targets for event study analysis and 114 targets for ratio analysis, the results for average abnormal returns of firms in Indonesia and Korea were inconclusive. However, the results for Malaysia, Thailand and the Philippines suggest that the market had reacted positively by adding value to the target firms upon merger announcements. The results show a marginal improvement in the performance or perceived growth opportunities as measured by the adjusted Tobin's q. The findings reflect the heterogeneity and complexity of the causes and effects of CBMAs in this region.

However these results did not translate to real accounting returns in terms of profitability ratios such as return on assets (ROA) and return on equity (ROE). Financial characteristics of the firms in terms of free cash flow (FCF) and free cash flow per share

CHAPTER ONE

INTRODUCTION

1.0 Background of the Study

Mergers and acquisitions (M&As) have been popular forms of business investments in a free open market. The trend in M&As shows that cross-border mergers and acquisitions (CBMAs) are getting more popular as a form of investment (Pricewaterhousecooper, 2004; Sidhu, 2006). It can be seen that firms' motivation was the primary determinant of decisions to undertake CBMAs. However, changes in technology, regulatory framework, and economic conditions in the home and host economies also greatly facilitated the growth of CBMAs (Pricewaterhousecooper, 2004).

Cross-border mergers (CBM) as defined by United Nations Conference on Trade and Development (UNCTAD) (2000, p.99) is when the assets and operation of two firms belonging to two different countries are combined to establish a new legal entity while in a cross-border acquisition (CBA), the control of assets and operations is transferred from a local to a foreign company, the former becoming an affiliate of the latter. CBMA activities represent massive reallocation of resources within and between economies where the main objective is to channel the corporate assets towards their best possible use.

Although CBMAs have been found to be mainly concentrated in industrialised economies, Chen and Findlay (2003) reported that CBMA sales have increased dramatically since the mid-1990s in the developing economies, particularly in the five Asian economies most affected by the financial crisis, including Indonesia, Malaysia, the Philippines, Korea and Thailand. Metwalli and Tang (2002) found that in the 1990s,

CHAPTER TWO

RELATED LITERATURE

2.0 Introduction

Chapter One has discussed the background of the study and issues related to CBMAs thus leading to the objectives of this study. This chapter aims to provide related literature on the characteristics of CBMAs in terms of its trends, theories, motives, effects, and determinants of post-CBMA performance. Based on the theories and previous empirical findings, the hypotheses for this study are developed.

2.1 Characteristics Of CBMAs

Theoretically, both CBMAs and Greenfield foreign direct investment (FDI) are foreign investments from a host economy's point of view (Chen and Findlay, 2003). United Nations Conference on Trade and Development (UNCTAD, 2000) describe CBMAs as:

> *"A firm can undertake FDI in a host country in either one of two ways: Greenfield investment in a new facility or acquiring or merging with an existing local firm. The local firm may be privately or state owned: privatisations involving foreign investors count as CBMA, which entails a change in the control of the merged or acquired firm. In a cross-border merger (CBM) the assets and operation of the two firms belonging to two different countries are combined to establish a new legal entity. In a cross-border acquisition (CBA), the control of assets and operations is transferred from a local to a foreign company, the former becoming an affiliate of the latter" (p.99)*