The Effect of M&A Announcements on the Stock Price Behavior in the Greater China Area

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Executive Summary

Problem

Over the recent years, M&A transactions have been announced in business related press on a daily basis. Rapid globalization, low interest rates and excess liquidity were shown to be common forces for boosting M&A activities. Often, the benefits of conducting M&A are referred to as obtaining synergy gains and creating shareholder value. There is a large western economic literature that investigates the abnormal returns of the bidding and target firms upon the M&A announcement day, and to what extent company- and deal specific factors have an influence on the stock price reaction. This thesis should contribute to the knowledge of the field from the perspective of the Chinese market with an additional focus on regulatory aspects, China's unique share segmentation and the government's role in participating in M&A activities.

Research Objective

The primary objective of this research is to empirically investigate whether M&A activities can create value for the shareholders of publicly listed Chinese acquirer companies by measuring abnormal returns on the M&A announcement date.

The second objective is to evaluate the M&A success factors, which have an effect on the cumulative abnormal returns (CAR) of the bidding firms. In addition to a selection of value drivers that have been present in the Anglo-Saxon market, such as the offer of payment in cash, inclusion of a financial advisor, industry relatedness between the acquirer and target company, relative deal size and the market-to-book value of the bidding firm a few Chinese market and regulatory environment specific considerations are also examined in this research. In order to expand the results of those two objectives and to provide a more complete picture of conducting M&A in the Greater China region, the economies from Hong Kong, Taiwan and Singapore are included also in the analysis.

Proceeding

The data of mergers and acquisitions including all deal specific characteristics is taken from the Thompson One Banker Database, an online database for M&A activities produced by Thomson Financial Corporation. All deals of publicly listed Chinese, Hong Kong, Taiwanese and Singaporean acquiring companies that were announced between January 1, 2000 and October 31, 2010 are included in this research.

The study includes a total of 762 Chinese M&A deals which can further be divided in 364 deals undertaken by acquirer firms listed at the Shanghai Stock Exchange, 307 deals by acquirer firms listed at the Shenzhen Stock Exchange and 91 deals by acquirer companies listed at the Hong Kong Stock Exchange. Additionally, the sample is expanded with a total of 1124 M&A deals taking place in the Greater China region.

In a first step, average abnormal returns (AAR) for each single day during a period between ten consecutive days prior and ten consecutive days after the announcement date (day 0) are reported. In a second step, cumulative average abnormal returns (CAAR) of various time periods such as the pre-announcement period during day -10 to day -1, the short-term announcement period during day -1 to day 1, the post-announcement period during day 1 to day 10 and finally a long-term announcement period from day -10 to day 10 are included in the analysis. The latter event period is used to fully integrate the effect of information that may have leaked prior to the announcement but also considers potential lagged market reaction.

In a last step, a variety of regression models are used to test what factors affect the CAR of bidding firms.

Results

Using the market model by Brown and Warner (1985), the results on the abnormal returns point to a significantly positive impact of the M&A announcements on the stock performance of bidding firms from Mainland China and Greater China on both stand-alone and accumulative days surrounding the official date of M&A disclosure. This indicates that the investors and shareholders are in favor of the deals and are willing to buy or hold more stocks of the bidding company. This causes the actual stock returns to outperform the expected return. Overall, it can be argued that the hypothesis stipulating that there are no abnormal returns upon M&A announcements can be rejected. A further split of the Chinese stock market reveals that the market reaction in Mainland China primarily follows the mechanism of the Shanghai Stock Exchange, whereas there are no significant abnormal returns for Chinese bidder firms listed at the Shenzhen and Hong Kong Stock Exchange.

After controlling for various deal and bidder specific characteristics, the OLS regression analysis identifies a large number of determinants that significantly impact the wealth gains or losses in form of abnormal returns of both Mainland China and Greater China bidders upon the public M&A press report.

In light of the increasing promulgations of M&A regulation starting in 2001, this report presents reducing abnormal returns for Chinese bidding firms during the period of 2000 to 2006, which also partially concur to the findings of Chi et al. (2010) who found consecutively decreasing abnormal returns during 1998 and 2003 for Chinese acquirer firms. Furthermore, following the year of China’s overhaul on M&A rules for foreign investors in 2006, the results show a positive impact on the financial performance of the Greater China companies that engaged in M&As with a target company from Mainland China.

Notably, this thesis has found that there is significant evidence that the shareholders of Chinese bidding firms react negatively to related M&A deals which conversely implies that diversification can create value gains.

Moreover, this study does not show any significant implications of the cross-border effect on China’s stock price behavior. In contrast to that, the Greater Chinese acquirer firms exhibit significantly negative abnormal returns when acquiring a foreign enterprise which concurs to the findings of Moeller and Schlingemann (2005).

As a further major finding, this report shows no significant direct influence of the government on the abnormal returns but suggests that the government involvement has explanatory power in interaction with other independent variables. For example, related deals, where the government is involved on the buy side, are likely to create positive bidder shareholder gains. This implies that the government has enhanced capacity to consolidate and achieve synergy gains. In terms of cross-border deals, however, the analysis shows that the government cannot bring excess returns to the bidder share price.

Another striking result, observed in both the Chinese and Greater Chinese market, is the significantly positive correlation between the inclusion of a financial advisor and the abnormal returns. To put differently, financial advisors, e.g. investment banks, are able to complete the deals faster and more efficiently and thus create shareholder value.

Furthermore, this paper shows a very significant negative correlation between the market-to - book value and the abnormal returns of the Chinese and Greater Chinese bidder firms. Other determinants that have been examined are the relative deal size and the cash offer. While the former positively affects the bidder gains in both the Chinese and Greater Chinese market, the latter variable does not have an impact on the firms from Mainland China but negatively affects the bidder firms from the Greater China.

With regard to the different types and sizes of the listed firms on the three different stock exchanges of Mainland China, the breakdown analysis shows that the value drivers on the Shanghai Stock Exchange are more or less in accordance to those of the aggregated Chinese stock market, whereas the Hong Kong Stock Exchange only partially concurs. In contrast, the regression analysis shows that the theoretically assessed determinants of abnormal returns do not have any explanatory power on the Shenzhen Stock Exchange.