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(出版者 / Publisher)

Institute of Comparative Economic Studies, Hosei University / 法政大学比較経済研究所

(雑誌名 / Journal or Publication Title)

比較経済研究所ワーキングペーパー

(巻 / Volume)

132

(開始ページ / Start Page)

1

(終了ページ / End Page)

21

(発行年 / Year)

2007-10-12

Mergers and Acquisitions in a Transition Economy: Recent Experiences of China and India

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ABSTRACT

This paper examines the causes and consequences of mergers and acquisitions in a transition economy using the 1998-2005 deal data for targeted Chinese and Indian firms. Our empirical analysis resulted in three important findings. First, firms with high cash reserve ratio are likely to be targeted in the recent cross-border acquisition trends in China and India. Second, cross-border acquisitions brought higher shareholders' values than those made by domestic acquirers. Third, own industry acquisitions also brought higher shareholders' values in these countries.

JEL Classification: O21, O25, G34

Keywords: Transition Economy, Mergers and Acquisition

I. Introduction

There is a vast literature on corporate acquisitions including several empirical studies on the causes and consequences of mergers and acquisitions. Some suggested technological innovations, industrial deregulations and changes in demographic structures as the major causes. Others reported that acquisitions brought about both positive and negative impacts in the post-acquisition period. Most of the literature used datasets of U.S. firms, but the number of studies using data from other countries has recently increased as merger waves hit other countries around the world. Clearly, there is an increasing merger wave hitting not only the industrialized countries, but also emerging countries as the latter promote economic transition by releasing state-owned shares.

In East Asia, the number of acquisitions by foreign firms dramatically increased after the 1997/98 financial crisis. One of the causes cited was the enhanced

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purchasing power of foreign acquirers following the currency devaluation and stock price fall in the region. Other triggers mentioned included the widespread privatization of state-owned enterprises and deregulation of capital transactions. However, ten years have passed since the crisis and the number of corporate acquisitions has been increasing still, especially in emerging countries. Remarkably, transition economies that did not experience currency crisis recorded even larger number of mergers and acquisitions. One possible reason for this dramatic increase is that foreign firms have become more aggressive purchases of the released shares of state-owned enterprises, at the same time that governments in transition economies have been promoting inward investments by deregulating the existing legislations.

According to United Nations Conference on Trade and Development, total international direct investment exceeded US\$ 900 billion in 2005 with a significant increase contributed by the emerging countries. In fact, cross-border corporate acquisitions accounted for forty two percent of international direct investment flow in the same year. The Chinese Eleventh Five-year plan of 2006 explains how the government regards the recent acquisition trend and the purpose of inward investment promotion policy. Specifically, the government expects incoming cross-border acquisition to bring with it advanced technology, stronger managerial discipline, and wider international delivery channels in addition to larger private equity funds. This background suggests that merger waves would hit both industrialized and emerging countries more frequently, resulting in higher international direct investments. For emerging transition economies, governments are more likely to take this approach to activate stagnating firms.

A series of literature using U.S. sample firms pointed out three factors that encourage acquisition to contribute to corporate value maximization. First, an acquisition enables the acquirer to obtain new technology and higher productivity¹. Second, the acquirer expects the corporate acquisition to improve the managerial discipline of the targeted firm as noted by Jensen (1986) and Bhagat et al.. (2005). Third, shareholders' potential rights to eliminate nonperforming managers contribute to an increase in corporate value regardless of the turnover by acquisition². While, the number of existing literature on mergers and acquisitions focusing on China and India is very small, the above implications from existing literature can be used to explain the recent acquisition trend in transition economies. It is possible that the Chinese and the Indian governments let privatized state-owned firms to obtain the synergy effect and managerial discipline by promoting corporate acquisition. In the case of cross-border acquisitions, the expected return from a transfer of new technology, management know-how, and more international delivery channels seem

¹ See Bradley, et.al (1988) , Andrade et.al.(2001) and Mitchell and Mulherin(1996), for example.

² Morck et.al.(1998) and Lang. et.al.(1989) discussed this matter in the existing literatures.

to be attractive enough to increase the productivity of state-owned firms in China and India.

Based on the above background, this paper will examine three propositions. The first is to verify common characteristics of target firms that acquirers prefer. We will empirically test what determinants influence the acquirer's investment decision by looking at the type of deals. The second is to find out how the capital market evaluates the announcement of acquisition. In particular, the types of acquisition that bring larger shareholder's value will be examined. The third is to verify and evaluate universal common characteristics of acquirers that bring larger shareholder's value. By using acquisition deal data matched with firms' financial statements, this paper derives conclusions of causes and consequences of the above in China and India.

II. Data

The empirical data are obtained from Bloomberg's "M&A League Table". The data set covers all the announced data of the world including deals with low percentage of stock targeting ratio and those in emerging countries. We used sample data of deals announced from January 1, 1998 - December 31, 2005. Sample targeted firms refer to both listed and unlisted firms in China and India. We extracted announced deals with more than fifty percent of targeted stock holding ratio. Differing from existing studies focusing on target firms in the industrialized countries, we did not set any lower bound for the total amount of deal value. The acquirers refer to all domestic and foreign listed firms, except firms in the financial sector and utilities. We also excluded in the sample those acquirers with more than two deals within five business operating days because it is difficult to specify which deal influenced an increase in the acquirer's stock price. Information on type of payment in China and India are not covered by Bloomberg's database and difficult to obtain from any other databases, and are also excluded in this study³.

Table 1 suggests that the number of acquisitions in China and India dramatically increased since 2002. In China, the number grew from 187 in 2001 to 949 in 2005. For both countries, the increased number of deals for the targeted unlisted firms was remarkable. In India, the ratio of publicly listed targets was high until 1999, but it dramatically decreased since 2002. Foreign acquirers, meanwhile, contributed to the increased number of unlisted targets in China and India with unlisted firms

³ In China, "Provisional Rule of Corporate Acquisition by Foreigners" came into effect in April 2003. It is said that the Chinese government has encouraged foreign institutional investors to acquire a firm in China since then. This rule was jointly made amendment by The Ministry of Commerce, State Administration of Foreign Exchange and The China Securities Regulatory Commissions in September 2006 as "A Rule for Foreign Investors to Acquire Chinese Firm". The rule contains the detailed regulations and allows foreign acquirers to employ stock as a method of payment.

targeted by foreign acquirers for both countries at more than thirty percent of total deals.

In terms of targeted industrial group, Table 2 shows a large number of targeted firms in real estate business and construction, reflecting the recent domestic construction boom in Chinese and Indian metropolitan areas. The number of firms in telecommunications is also large in China which can be attributed to the recent progress of deregulation in this sector since China joined WTO in 2001. The number in financial services is also large in China and in the pharmaceutical industry in India. These data point to the common trend of an increasing number in targeted firms in the recently deregulated industrial group. However, country specific factors also exist as shown in Chinese financial business and Indian pharmaceutical industry.

This paper employs three approaches in examining the causes and consequences of acquisitions in China and India. The first approach examines if determinants of targets influencing an acquirer's decision differ between domestic deals and cross-border deals. The second approach is to verify what types of deals recorded high cumulative abnormal returns by using event study. This approach adopts the methodology of Brown&Warners (1985) and examines if there are differences between domestic and cross-border deals. Third, is to examine what type of acquirer's character brings about high abnormal returns for both domestic and cross-border deals. Taking into consideration the acquisition boom during the period, the sample period for the first approach covers 2001-2005. The second and third approaches employ data from 1998 to 2005 and from 2000 to 2005, respectively.

Table 1 **Number of Mergers and Acquisitions in China and India**

(a) China	Number of M&A	Publicly Listed Targets	Foreign Acquirers	Own Industry M&A
1998	5	0 (0.0%)	5 (100.0%)	0 (0.0%)
1999	31	0 (0.0%)	24 (77.4%)	5 (16.1%)
2000	119	2 (1.7%)	83 (69.7%)	15 (12.6%)
2001	187	4 (2.1%)	105 (56.1%)	39 (20.9%)
2002	662	30 (4.5%)	153 (23.1%)	112 (16.9%)
2003	562	28 (5.0%)	169 (30.1%)	105 (18.7%)
2004	720	16 (2.2%)	292 (40.6%)	155 (21.5%)
2005	949	22 (2.3%)	317 (33.4%)	199 (21.0%)
(b) India	Number of M&A	Publicly Listed Targets	Foreign Acquirers	Own Industry M&A
1998	19	10 (52.6%)	6 (31.6%)	9 (47.4%)
1999	70	37 (52.9%)	31 (44.3%)	21 (30.0%)
2000	91	17 (18.7%)	43 (47.3%)	24 (26.4%)
2001	103	27 (26.2%)	30 (29.1%)	48 (46.6%)
2002	127	21 (16.5%)	32 (25.2%)	49 (38.6%)
2003	128	13 (10.2%)	51 (39.8%)	51 (39.8%)
2004	138	22 (15.9%)	51 (37.0%)	49 (35.5%)
2005	227	31 (13.7%)	79 (34.8%)	104 (45.8%)

Source: Authors' Calculation Based on Bloomberg

Note: The sample contains all completed mergers and acquisitions in China and India between 1998 and 2005. Targets are comprised of public, private, and subsidiary firms. Acquirers include both foreign and domestic firms. Samples are the announced deals with more than fifty percent of targeted stock holding ratio. No lower bound for the total amount of deal value is set. The acquirers are all domestic and foreign

listed firms except firms in the financial sector and utilities. Deals with more than twice within five business operating days are excluded from the samples.

Table 2. The Number of Takeover Activity in China and India (1998-2005)

(a) China

(b) India

	Targets				Acquirers				Targets				Acquirers		
	N	%	Publicly Listed Targets (%)	Own Industry Acquisitions (%)	N	%	Foreign Acquirers (%)		N	%	Publicly Listed Targets(%)	Own Industry Acquisitions(%)	N	%	Foreign Acquirers(%)
Agriculture	18	1.5%	0.0%	44.4%	21	1.7%	38.1%	Agriculture	11	2.2%	36.4%	36.4%	11	2.2%	27.3%
Aircraft	4	0.3%	0.0%	100.0%	6	0.5%	33.3%	Aircraft	0	0.0%	N.A.	N.A.	0	0.0%	N.A.
Apparel	3	0.2%	0.0%	66.7%	19	1.6%	31.6%	Apparel	1	0.2%	0.0%	0.0%	0	0.0%	N.A.
Automobiles	34	2.8%	17.6%	52.9%	23	1.9%	43.5%	Automobiles	16	3.2%	31.3%	56.3%	19	3.7%	21.1%
Business services	98	8.1%	1.0%	35.7%	62	5.1%	58.1%	Business services	34	6.7%	44.1%	55.9%	47	9.3%	34.0%
Business supplies	1	0.1%	0.0%	100.0%	1	0.1%	100.0%	Business supplies	44	8.7%	0.0%	0.0%	38	7.5%	0.0%
Chemicals	43	3.5%	20.9%	39.5%	33	2.7%	45.5%	Chemicals	0	0.0%	N.A.	N.A.	0	0.0%	N.A.
Computers	51	4.2%	3.9%	27.5%	46	3.8%	50.0%	Computers	16	3.2%	56.3%	56.3%	18	3.6%	22.2%
Construction	41	3.4%	7.3%	43.9%	39	3.2%	41.0%	Construction	44	8.7%	13.6%	50.0%	45	8.9%	26.7%
Construction materials	4	0.3%	0.0%	75.0%	3	0.2%	66.7%	Construction materials	16	3.2%	56.3%	93.8%	17	3.4%	17.6%
Consumer goods	6	0.5%	0.0%	16.7%	8	0.7%	50.0%	Consumer goods	2	0.4%	0.0%	100.0%	4	0.8%	0.0%
Defense	2	0.2%	0.0%	50.0%	5	0.4%	0.0%	Defense	3	0.6%	0.0%	0.0%	3	0.6%	0.0%
Electrical equipment	41	3.4%	7.3%	48.8%	39	3.2%	30.8%	Electrical equipment	0	0.0%	N.A.	N.A.	0	0.0%	N.A.
Electronic equipment	64	5.3%	1.6%	46.9%	68	5.6%	83.8%	Electronic equipment	10	2.0%	20.0%	60.0%	9	1.8%	11.1%
Entertainment	8	0.7%	0.0%	50.0%	8	0.7%	87.5%	Entertainment	12	2.4%	33.3%	58.3%	19	3.7%	52.6%
Fabricated products	2	0.2%	50.0%	0.0%	2	0.2%	0.0%	Fabricated products	1	0.2%	0.0%	0.0%	1	0.2%	0.0%
Financial services	57	4.7%	1.8%	33.3%	124	10.2%	31.5%	Financial Services	2	0.4%	0.0%	100.0%	2	0.4%	50.0%
Food products	59	4.9%	1.7%	44.1%	35	2.9%	51.4%	Food products	32	6.3%	28.1%	81.3%	29	5.7%	27.6%
Healthcare	2	0.2%	0.0%	0.0%	0	0.0%	N.A.	Healthcare	0	0.0%	N.A.	N.A.	0	0.0%	N.A.
Insurance	0	0.0%	N.A.	N.A.	0	0.0%	N.A.	Insurance	0	0.0%	N.A.	N.A.	0	0.0%	N.A.
Machinery	34	2.8%	17.6%	44.1%	47	3.9%	19.1%	Machinery	6	1.2%	33.3%	16.7%	9	1.8%	22.2%
Measuring and control Equipment	26	2.1%	3.8%	57.7%	20	1.6%	70.0%	Measuring and control Equipmen	9	1.8%	22.2%	55.6%	7	1.4%	71.4%
Medical equipment	21	1.7%	9.5%	33.3%	21	1.7%	38.1%	Medical equipment	12	2.4%	0.0%	41.7%	8	1.6%	62.5%
Miscellaneous	149	12.3%	4.7%	32.9%	189	15.6%	40.2%	Miscellaneous	102	20.1%	10.8%	13.7%	78	15.4%	24.4%
Nonmetallic mining	11	0.9%	0.0%	72.7%	9	0.7%	44.4%	Nonmetallic mining	0	0.0%	N.A.	N.A.	0	0.0%	N.A.
Personal service	7	0.6%	0.0%	14.3%	5	0.4%	80.0%	Personal service	5	1.0%	0.0%	40.0%	4	0.8%	100.0%
Petroleum and natural gas	41	3.4%	12.2%	48.8%	37	3.0%	35.1%	Petroleum and natural gas	13	2.6%	53.8%	46.2%	19	3.7%	26.3%
Pharmaceutical	32	2.6%	3.1%	43.8%	27	2.2%	22.2%	Pharmaceutical	28	5.5%	42.9%	75.0%	33	6.5%	9.1%
Printing and publishing	8	0.7%	0.0%	25.0%	8	0.7%	37.5%	Printing and Publishing	2	0.4%	0.0%	100.0%	2	0.4%	50.0%
Real estate	121	10.0%	7.4%	39.7%	79	6.5%	29.1%	Real estate	4	0.8%	0.0%	25.0%	1	0.2%	100.0%
Recreational products	5	0.4%	0.0%	20.0%	6	0.5%	16.7%	Recreational products	0	0.0%	N.A.	N.A.	0	0.0%	N.A.
Restaurants, motels, hotels	6	0.5%	0.0%	0.0%	3	0.2%	0.0%	Restaurants, motels, hotels	4	0.8%	25.0%	50.0%	2	0.4%	0.0%
Retail	25	2.1%	12.0%	32.0%	41	3.4%	43.9%	Retail	4	0.8%	0.0%	50.0%	4	0.8%	25.0%
Rubber and plastics	8	0.7%	12.5%	75.0%	8	0.7%	50.0%	Rubber and plastics	2	0.4%	0.0%	50.0%	3	0.6%	0.0%
Shipbuilding, railroad	1	0.1%	0.0%	0.0%	0	0.0%	N.A.	Shipbuilding, railroad	0	0.0%	N.A.	N.A.	0	0.0%	N.A.
Shipping containers	3	0.2%	0.0%	66.7%	9	0.7%	33.3%	Shipping Containers	3	0.6%	66.7%	33.3%	3	0.6%	33.3%
Steel works	38	3.1%	2.6%	57.9%	35	2.9%	11.4%	Steel works	19	3.7%	42.1%	89.5%	30	5.9%	20.0%
Telecommunications	95	7.8%	3.2%	56.8%	87	7.2%	55.2%	Telecommunications	30	5.9%	10.0%	66.7%	25	4.9%	56.0%
Textiles	26	2.1%	11.5%	23.1%	14	1.2%	42.9%	Textiles	19	3.7%	36.8%	31.6%	14	2.8%	0.0%
Trading	9	0.7%	0.0%	22.2%	11	0.9%	18.2%	Trading	0	0.0%	N.A.	N.A.	0	0.0%	N.A.
Transportation	0	0.0%	N.A.	N.A.	0	0.0%	N.A.	Transportation	0	0.0%	N.A.	N.A.	0	0.0%	N.A.
Trash and waste	0	0.0%	N.A.	N.A.	3	0.2%	100.0%	Trash and waste	0	0.0%	N.A.	N.A.	0	0.0%	N.A.
Wholesale	10	0.8%	0.0%	50.0%	13	1.1%	61.5%	Wholesale	1	0.2%	0.0%	0.0%	3	0.6%	33.3%

Source: Authors' Calculation Based on Bloomberg

Note: this table reports, by industry, the fraction of sample firms that were acquired in 1998-2005. Targets are comprised of public, private, and subsidiary firms. Industry data are organized using Fama and French (1997) industry classifications. Column 3 and 7 report the number and percentage of acquirers and targets, respectively, in a particular industry. Column 4 and 5 report percentage of targets publicly listed and acquired by in their own industry, respectively.

III. Common Characteristics of the Chinese and Indian Targets

This section addresses the characteristics of targets that influence an investment decision of domestic and foreign acquirers. There are several studies that focused on this issue. By examining the free-cash flow problem and using it as a proxy for non-working internal control mechanisms of the firm, Hanson (1992) and Smith and Kim (1994) suggested that cash-rich firms are likely to be targeted. Using another approach, Hasbrouck (1985) and Morck et al.(1988) have shown that firms with high growth opportunities are less likely to be targeted because such firms do not need any external intervention. Existing literature generally focus on the relationship between characteristics of targets and efficiency of internal management mechanisms as suggested by Palepu(1986), Song and Walkling(1993) and Harford (1999). Our study also employs the same variables since firms in a transition economy need more external intervention.

Our study uses the acquisition's deal data and financial data of the listed targets in China and India from 1999 to 2005, and extracts deals with more than 50 percent targeting share of stock acquisition. Reflecting the above literature together with the Chinese and Indian country specific backgrounds, our first hypothesis is that the volume of internal cash reserve influences an investment decision of acquirer for both China and India. This is because there is stronger intervention in the internal corporate mechanism of cash-rich state-owned firms under a share releasing plan by the government. Our second hypothesis is that firms with high growth opportunities are likely to be targeted, contrary to the findings of existing literature. We consider foreign acquirers to have much larger purchasing power and incentives to maximize returns when the target shows good growth opportunity.

Our empirical model as shown in equations (1.1) and (1.2) employs 1 as a dependent variable when the firm is the target of an acquisition attempt and others are 0 in year t. The independent variable is the three-year averaged financial data. Therefore, the dependent variables are virtually the announced deals in 2001-2005. Seven industrial dummy and four year dummy variables are added to the equations.

$$y_{it}^1 = const + \alpha_1 SIZE_{it} + \alpha_2 DER_{it} + \alpha_3 CASH_{it} + \alpha_4 FIXED_{it} + \alpha_5 ROA_{it} + \alpha_5 MBR_{it} + d_t + u_i + v_{it} \quad (1.1)$$

$$y_{it}^2 = const' + \beta_1 SIZE_{it} + \beta_2 DER_{it} + \beta_3 CASH_{it} + \beta_4 FIXED_{it} + \beta_5 ROA_{it} + \beta_5 MBR_{it} + d_t' + u_i' + v_{it}' \quad (1.2)$$

y^1 : "1" when the firm is the target of a domestic acquisition attempt in year t, "0" when the firm is not the target of neither domestic nor cross-border acquisition attempt in year t, y^2 : "1" when the firm is the target of a cross-border acquisition attempt in year t, "0" when the firm is not the target of neither

domestic nor cross-border acquisition attempt in year t , SIZE: Logarithm of Total Assets, DER: Total Liability/Market Valued Capital, CASH: Cash Reserves/ Total Assets, FIXED: Fixed Assets/Total Assets, ROA: Return on Assets, , MBR: (Book Value of Total Liability + Market Value of Capital)/ Book Value of Total Assets

Our empirical analysis showed that in the case of acquisitions between domestic acquirers and targets in China, parameters of firm size, cash reserve ratio and fixed assets ratio are significant with the firm size negative and those of cash reserve ratio and fixed assets positive. In India, parameters of firm size and debt to equity ratio of firms are both negatively significant. For cross-border acquisitions, parameters of cash reserve ratio and market to book ratio are positively significant in China, while cash reserve ratio and fixed assets ratio are both positively significant in case of Indian firms.

These results confirm our first hypothesis that firms with ample cash are likely to be targeted, at least for Chinese firms. The same is true for cross-border acquisition in India. This variable is a proxy if there is intervention in the management of firms. Therefore, our empirical results suggest that the cash rich Chinese and Indian firms would need acquirers' intervention for them to operate efficiently.

On the other hand, it is difficult to confirm our second hypothesis. The parameter of market to book ratio in the case of cross-border acquisitions in China is positively significant and supports the hypothesis. However, those in other three equations are insignificant. The parameter firm size is negatively significant for both Chinese and Indian domestic acquisitions. Mikkelson and Partch (1989) and Song and Walking (1993) also reported that size negatively relates to target incidence. Our study also found a similar trend in this variable. Parameters of several industrial dummy variables are significant. These suggest that industrial effects are also important factors in acquirers' decision making.

Table 3. The Empirical Results of Determinants of a Target

(A) China

(a) Domestic Acquisitions

(b) Cross-border Acquisitions

	Coefficient	Z-Value		Coefficient	Z-Value
SIZE	▲ 0.090 **	▲ 2.380	SIZE	0.209	0.950
DER	0.014	1.560	DER	0.000	0.000
CASH	0.756 ***	3.130	CASH	9.318 ***	5.570
FIXED	0.049 ***	2.790	FIXED	0.071	1.510
MBR	0.060	1.220	MBR	0.777 ***	4.490
SECTOR_1	0.134	1.190	SECTOR_1	▲ 0.882	▲ 1.330
SECTOR_2	0.086	0.740	SECTOR_2	0.375	0.860
SECTOR_3	0.149	1.190	SECTOR_3	0.200	0.380
SECTOR_4	▲ 0.117	▲ 0.520	SECTOR_4	0.211	0.400
SECTOR_5	▲ 0.471	▲ 1.050	SECTOR_5	▲ 5.340	▲ 0.001
SECTOR_6	▲ 0.041	▲ 0.170	SECTOR_6	▲ 6.091	▲ 0.001
SECTOR_7	0.445 **	2.230	SECTOR_7	0.320	0.380
Year_1	0.019	0.140	Year_1	0.249	0.440
Year_2	0.044	0.340	Year_2	▲ 0.070	▲ 0.120
Year_3	0.100	0.800	Year_3	▲ 0.344	▲ 0.600
Year_4	▲ 6.096	▲ 0.001	Year_4	0.264	0.48
Constant	▲ 1.800 ***	▲ 4.670	Constant	▲ 13.281 ***	▲ 5.390
Wald chi2	37.890		Wald chi2	53.850	
rho	0.820		rho	0.220	
Likelihood-Ratio Test of rho=0	1.630		Likelihood-Ratio Test of rho=0	1.580	
Number of Firms	1,113		Number of Firms	1,113	
Observations	3,650		Observations	3,650	

(b) India

(a) Domestic Acquisitions

(b) Cross-border Acquisitions

	Coefficient	Z-Value		Coefficient	Z-Value
SIZE	▲ 0.097 *	▲ 1.760	SIZE	▲ 0.094	▲ 0.990
DER	▲ 0.133 *	▲ 1.950	DER	▲ 0.065	▲ 0.620
CASH	▲ 0.420	▲ 1.190	CASH	3.028 ***	3.570
FIXED	0.009	0.790	FIXED	0.000	0.010
MBR	0.023	0.660	MBR	0.211 ***	5.050
SECTOR_1	▲ 0.042	▲ 0.220	SECTOR_1	▲ 0.111	▲ 0.330
SECTOR_2	▲ 0.541 **	▲ 2.150	SECTOR_2	▲ 0.795	▲ 1.610
SECTOR_3	▲ 0.475 *	▲ 1.870	SECTOR_3	▲ 0.711	▲ 1.510
SECTOR_4	0.993 **	2.570	SECTOR_4	▲ 5.782	▲ 0.001
SECTOR_5	▲ 0.359	▲ 1.380	SECTOR_5	▲ 0.433	▲ 1.010
SECTOR_6	▲ 0.454	▲ 1.210	SECTOR_6	▲ 5.916	▲ 0.001
SECTOR_7	▲ 6.017	▲ 0.001	SECTOR_7	▲ 5.974	▲ 0.001
Year_1	0.844 ***	4.110	Year_1	0.852 **	1.990
Year_2	▲ 0.484	▲ 1.670	Year_2	0.491	1.080
Year_3	▲ 6.155	▲ 0.001	Year_3	0.134	0.270
Year_4	▲ 6.187	▲ 0.001	Year_4	0.235	0.550
Constant	▲ 0.949 **	▲ 2.010	Constant	▲ 4.228 ***	▲ 3.590
Wald chi2	32.090		Wald chi2	30.970	
rho	0.018		rho	0.209	
Likelihood-Ratio Test of rho=0	0.010		Likelihood-Ratio Test of rho=0	0.970	
Number of Firms	695		Number of Firms	695	
Observations	2,853		Observations	2,853	

Note 1: This table represents the results of a panel probit that predicts which firms will be targeted in a given year. The empirical model employs 1 as a dependent variable when the firm is the target of an acquisition attempt and others are 0 in year t. The independent variable is the three-year averaged financial data. Therefore, the dependent variables are virtually the announced deals in 2001-2005. SIZE is the natural logarithm of total assets, DER is the total Liability divided by market valued capital, CASH is cash reserves divided by total assets, FIXED is fixed assets divided by total assets, ROA is return on assets,, MBR is book value of total liability plus market valued capital divided by book value of total assets.

Note 2: ***, ** and ` denotes significance at 1, 5 and 10 percent level, respectively

Note 3: In this estimation, seven categories of industrial dummy variables are added based on a definition of Bloomberg's "Industrial Sector Level I". The definition is different from that of table 2.

IV. What type of acquisitions increases shareholder's value?

The purpose of this section is to verify the consequences resulting from the recent acquisitions in China and India. Focusing on shareholders' gains from acquisitions, we examined if acquisitions contributed to an increase in shareholders' values in transition economies. We chose event study as a methodology to verify the above because we considered stock price as reflecting the future result of the acquisition. In other words, stock price right after the announcement reflects expected economic value added obtained by acquisitions. We followed a standard event study methodology to calculate abnormal returns originally developed by Brown and Warner (1985). We estimated the abnormal returns over three-day event window (-1, 1) around the announcement date using market model benchmark returns. We calculated abnormal returns and discussed the sources, causes and origins of the differences. The parameters for the market model are estimated over the (-256,-6) interval.

$$AR_i = r_i - r_m$$

Here, r_i is the return on firm i and r_m is the value-weighted market index return. By using the above three-day cumulative abnormal returns, this paper investigates the following three hypotheses. The first hypothesis is that foreign acquirers, i.e., cross-border acquisitions, brought larger shareholders' value than domestic acquirers. This hypothesis comes from the observation that foreign shareholders of the industrialized countries enhance monitoring of the corporate managers resulting in managerial discipline. Jensen (1986, 1988), Shleifer and Vishny (1986, 1998) emphasized the importance of shareholder's monitoring citing as an example the improvement in managerial discipline resulting from concentrated ownership structure. Jensen (1988) and Kaplan (1997) quoted LBO, i.e., using leveraged buyouts as a proxy for corporate ownership concentration and strong corporate monitoring, we assume that acquisition by foreign acquirer leads to enhancement of monitoring in addition to obtaining international distribution channels, new technology and other sources of high productivity.

Our second hypothesis is that the shareholders of an acquirer receive larger returns when the target is a publicly unlisted firm. This hypothesis is also based on existing literature in the United States. For example, Chang (1998) and Hansen and

Lott (1996) examined returns from private acquisition targets. The former suggested that unlisted firms have less concentrated ownership structure. Although Fuller et al (2002) questioned the above conclusions, our analysis showed that in a transition economy, acquisition of private firms leads to effective monitoring regardless of ownership concentration. Hansen and Lott (1996) pointed out the same view, but from another hypothesis. Their contention is that acquisition of a private firm leads to maximization of shareholder's portfolio, even though it did not maximize shareholder's value. We assume that the latter is also plausible in case of cross-border acquisition, particularly in emerging markets where international inward portfolio investment has been recently increasing.

The third hypothesis is that vertical acquisition, i.e., industrial sectors of acquirer and target are close, improves productivity in the industry and brings higher shareholder's value as a result. In the United States, Berger and Ofek (1995) reported that stock price of diversified firm is undervalued because investors regard that the firm misallocate the corporate resources and inefficiency exists inside. Morck et al. (1990) and Bhagat et al. (2005) also reported that stock price of the firm is higher when the industrial sectors of acquirer and target are close. Although some literature such as Agrawal et al. (1992) and Sirower (1997) reported that stock price of the horizontal acquisition brought higher stock price in their empirical results, we assume vertical acquisition brings better efficiency in resource allocation between acquirer and target.

This section examines a sample using several criteria. The first criterion refers to deals between both listed and private targets and publicly listed acquirers announced from 1 January 1998 to 31 December 2005. Deals with more than 50% announced acquisitions and completed as of May 31, 2007 are extracted from the sample. Banks, securities firms, insurance firms and other financial firms are excluded as an acquirer from the sample. Other deals that the same acquirer announced in five operating days are also excluded.

Table 4. shows the three-day cumulative abnormal returns classified by type of deals. In table 4.A., cumulative abnormal return of full sample is significantly positive in China. However, when we differentiate the returns on the basis of whether the acquirer is a foreign firm or Chinese firm, we find that the return is significantly positive for foreign acquirers. As for the cumulative abnormal returns on the basis of whether the target is a publicly listed firm or not, we find that the return is significantly higher when the target is unlisted firm. These results are common for both cross-border and domestic acquisitions in China. The cumulative abnormal return is also significantly high when the foreign acquirer and domestic target belong to the same industry. However, it is insignificant when the acquirer is a domestic firm. To summarize, the above empirical results suggest that a foreign acquirer belonging to the same industrial group as an unlisted target provides the most significant positive additional shareholder's value in China.

Table 4.B shows the empirical results of acquisitions in India. The results of the tests for all samples suggest that cumulative abnormal return of acquirer's shareholder is significantly positive in India as a whole. The returns of both cross-border and domestic acquisitions are also significantly positive, but the cross-border acquisition is significantly higher than the domestic. In testing for the difference of cumulative abnormal returns between the listed and unlisted target, we find that the returns is significantly higher when the target is unlisted in case of cross-border acquisition. The result of the test is insignificant when acquirer is domestic firm. In India, empirical results suggest that the cumulative abnormal return of own-industry acquisition is significantly higher in case of cross-border acquisitions. When the acquirer is a domestic firm, the difference of the return between own industry and non-own industry acquisition is insignificant. The above results suggest that cross-border acquisition also brings more significant additional shareholder's value in India and the returns are higher when the target is an unlisted firm and belongs to the same industrial group.

Table 4. Cumulative Abnormal Returns of Acquirers by Type of M&A

A. China

(a) Cumulative Abnormal Returns of Acquirers of Cross-border and Domestic M&A

	All (1)		OUT-IN (2)		IN-IN (3)		Difference (2)-(3)	
Mean	2.50% ***	[4.30]	3.02% ***	[3.55]	0.51% **	[0.02]	2.51% ***	[2.64]
Median	0.37% ***	[4.24]	0.36% **	[2.41]	0.31% ***	[0.01]	0.05% *	[0.80]
Observations	828		411		344			

(b) Cumulative Abnormal Returns of Acquirers by Type of Targets

	All (1)		Public (2)		Private (3)		Difference (2)-(3)		
OUT-IN	Mean	3.91% ***	[4.01]	1.85% *	[1.58]	5.07% ***	[3.69]	-3.22% *	[1.59]
	Median	0.43% ***	[3.47]	2.13%	[1.11]	0.47% ***	[3.51]	1.66%	[0.23]
Observations	485		310		175				
IN-IN	Mean	1.99% ***	[2.50]	0.32%	[0.48]	3.07% ***	[2.48]	-2.75% **	[-1.69]
	Median	0.42% ***	[3.70]	0.17% *	[1.89]	0.60% ***	[3.17]	-0.44%	[-0.42]
Observations	418		164		254				

(c) Cumulative Abnormal Returns of Acquirers by Type of Industrial Sector

		All (1)		Own-Industry (2)		Non-Own Industry (3)		(2)-(3)	
OUT-IN	Mean	3.91% ***	[4.01]	5.39% **	[1.79]	3.50% ***	[3.77]	1.89% ***	[2.44]
	Median	0.43% ***	[3.47]	0.75% *	[1.75]	0.38% ***	[2.97]	0.37%	[0.43]
Observations		485		380		105			
IN-IN	Mean	0.20% ***	[2.50]	4.12%	[1.24]	1.61% **	[2.33]	2.51%	[1.22]
	Median	0.44% ***	[3.76]	0.60%	[1.64]	0.40% ***	[3.40]	0.20%	[0.15]
Observations		416		73		343			

Note 1: Cumulative abnormal returns for acquirers are calculated for the three days (-1, 1) around the announcement of a takeover. Abnormal returns are estimated using a below model:

$$AR_i = r_i - r_m$$

The parameters for the market model are estimated over the (-256,-6) interval. Here, r_i is the return on firm i and r_m is the value-weighted market index return. All acquirers are publicly traded listed on the domestic/foreign stock exchange.

Note 2: *** denotes significance at 1 percent level, ** denotes significance at 5 percent level and * denotes significance at 10 percent level

B. India

(a) Cumulative Abnormal Returns of Acquirers of Cross-border and Domestic M&A

	All (1)		OUT-IN (2)		IN-IN (3)		Difference (2)-(3)	
Mean	1.18% ***	[2.88]	1.94% **	[2.05]	0.93% ***	[2.89]	1.02% ***	[2.88]
Median	0.15% *	[1.70]	0.36% *	[1.69]	0.08% **	[2.13]	0.28% ***	[0.99]
Observations	489		220		349			

(b) Cumulative Abnormal Returns of Acquirers by Type of Targets

	All (1)		Public (2)		Private (3)		Difference (2)-(3)		
OUT-IN	Mean	0.64% *	[1.58]	0.94% **	[2.05]	1.16%	[0.31]	-0.22% **	[-2.23]
	Median	0.36% **	[2.09]	0.34% *	[1.69]	0.36%	[1.41]	-0.02% ***	[-0.91]
Observations	306		220		158				
IN-IN	Mean	1.18% ***	[2.88]	1.02% *	[1.59]	1.40% ***	[3.59]	-0.38%	[-0.46]
	Median	0.08% *	[1.70]	0.08%	[0.33]	0.11% ***	[2.22]	-0.03%	[-0.62]
Observations	489		287		202				

(c) Cumulative Abnormal Returns of Acquirers by Type of Industrial Sector

	All (1)		Own-Industry (2)		Non-Own Industry (3)		(2)-(3)		
OUT-IN	Mean	0.64% *	[1.58]	1.13%	[0.15]	0.94% **	[2.05]	0.18% **	[2.05]
	Median	0.36% *	[2.09]	0.96%	[1.15]	0.18% *	[1.69]	0.78% *	[1.69]
Observations	489		86		403				
IN-IN	Mean	0.12% ***	[2.88]	1.80% *	[1.52]	0.93% ***	[2.89]	0.87%	[0.96]
	Median	0.08% *	[1.70]	-0.26%	[-0.33]	0.16% **	[2.13]	-0.42%	[-0.62]
Observations	489		140		349				

Note 1: Cumulative abnormal returns for acquirers are calculated for the three days (-1, 1) around the announcement of a takeover. Abnormal returns are estimated using a below model:

$$AR_i = r_i - r_m$$

The parameters for the market model are estimated over the (-256,-6) interval. Here, r_i is the return on firm i and r_m is the value-weighted market index return. All acquirers are publicly traded listed on the domestic/foreign stock exchange.

Note 2: Each industrial sector of the sample deal is defined based on Table 2.

Note 3: *** denotes significance at 1 percent level, ** denotes significance at 5 percent level and * denotes significance at 10 percent level.

V. What types of acquirers contribute to a good acquisition?

The third empirical analysis focuses on types of acquirers that bring high cumulative abnormal returns. The four datasets are prepared to examine this, i.e., two datasets for domestic acquisitions and the two others for cross-border acquisitions in China and India, respectively. The sample period covers 2000 to 2005. We matched financial data of acquirers to the CARs estimated in the previous section. The criterion used to extract sample data of the acquisition is the same as in sections III and IV.

Existing literature on this issue is also ample. Moeller et al. (2004) , Dong et al. (2002) and Malmendier and Tate (2002) pointed out that acquirer's firm size is important in determining shareholders' return based on their research on U.S. acquisitions. The above literature mentioned various reasons, but we do not share their view on overpayment by large firms. But we do agree that a small acquirer obtains relatively larger synergy effect than large firms and uses the same hypothesis it in this paper.

Lang et al. (1989) pointed out that acquirers with high market to book ratio resulted in high cumulative abnormal returns in eleven days after the announcement. This is because the acquirer with high market to book ratio is regarded to bring better efficiency in management for the target. Servaes (1991) supported the above view and the study suggests that the target has a room for efficiency improvement from an acquirer with high market to book ratio. Although Rau and Vermaelen (1998) questioned the results of the above literatures⁴, we assume that a high market to book ratio acquirer also improves the productivity of firms in China and India.

The third hypothesis is that the deal produces high shareholder's value when the acquirer and the target are from the same industry and the target is an unlisted firm. This hypothesis comes from an observation that there is information asymmetry between acquirers and targets and this reflects the shareholder's value after the deal announcement. In addition, acquirers do due diligence intensively when the target

⁴ Their view is acquisition by a glamour firm, i.e., high market to book ratio firm, is highly evaluated when announced, but makes a downward revision sooner or later.

is an unlisted firm. We also thought this reflected shareholder's value in a market.

$$Z_i^1 = const + \chi_1 SIZE_i^1 + \chi_2 MBR_i + \chi_3 CASH_i + \chi_4 FIXED_i + \chi_5 ROA_i + \chi_6 GROWTH_i + \chi_7 PUBLIC_i + \chi_7 OWN_i + t_i \quad (1.1)$$

$$Z_i^2 = const + \delta_1 SIZE_i^2 + \delta_2 MBR_i + \delta_3 CASH_i + \delta_4 FIXED_i + \delta_5 ROA_i + \delta_6 GROWTH_i + \delta_6 PUBLIC_i + \delta_7 OWN_i + t_i \quad (1.2)$$

Z¹: Cumulative Abnormal Return of Domestic Acquirer, Z²: Cumulative Abnormal Return of Foreign Acquirer, SIZE¹: Logarithm of Total Assets in terms of local currency, SIZE²: Logarithm of Total Assets in terms of US dollar, MBR: Book Value of Total Liability plus Market Value of Capital divided by Total Assets, CASH: Cash Reserve divided by Total Assets, FIXED: Fixed Assts divided by Total Assets, ROA: Return on Asset, GROWTH: Growth Rate of Sales, PUBLIC: Dummy variable with a value of 1 if the targets are listed, or 0 otherwise, OWN: A Dummy Variable with a value of 1 if the Targets are in same industrial group, or 0 otherwise.

Our empirical results suggest that parameters of MBR, CASH and GROWTH are significant in case of acquisitions by domestic acquirer in China. Here, the sign of the parameters MBR and GROWTH are positive, that of CASH is negative. This means that cumulative abnormal return is statistically high when acquirer is a domestic firm with high MBR and GROWTH. On the other hand, these parameters are insignificant when acquirer is foreigner and does not contribute to an increase in the shareholder's value. In India, the shareholder's value increases when the acquirer is domestic, the target is unlisted and the two belong to one industrial group. For Indian firms, cumulative abnormal return is high when the acquirer is a domestic, the target is unlisted and these two belong to a close industrial group. However, only the parameter of ROA is significantly positive and all the others are insignificant.

Table 5. The Empirical Results of Determinants of CAR by Type of Merger

(a)China

IN-IN M&A	Coefficient	Z-Value	OUT-IN M&A	Coefficient	Z-Value
SIZE	0.007 *	1.620	SIZE	▲ 0.000	▲ 0.120
MBR	0.009 ***	2.720	MBR	▲ 0.004	▲ 1.200
CASH	▲ 0.063 **	▲ 2.310	CASH	0.011	0.300
ROA	0.063	1.060	ROA	0.014	0.620
GROWTH	0.002 ***	5.860	GROWTH	▲ 0.000	▲ 0.400
PUBLIC	▲ 0.001	▲ 0.140	PUBLIC	0.009	1.090
OWN	▲ 0.006	▲ 0.820	OWN	0.001	0.120
Year_1	(dropped)		Year_1	(dropped)	
Year_2	0.005	0.330	Year_2	▲ 0.010	▲ 0.840
Year_3	0.024	1.640	Year_3	▲ 0.010	▲ 0.780
Year_4	0.015	1.060	Year_4	▲ 0.022	▲ 1.770
Year_5	(dropped)		Year_5	(dropped)	
Constant	▲ 0.059 *	▲ 1.770	Constant	0.028	1.690
Number of Firms	206		Number of Firms		240
Adj R-squared	0.169		Adj R-squared		0.057

Note 1: Ordinary least squares regression of the acquirer's three day cumulative abnormal return on the on the following variables. SIZE1 and SIZE2 are the logarithm of total assets in terms of local currency and US dollar, respectively. MBR is book value of total liability plus market value of capital divided by total assets. CASH is cash reserve divided by total assets. FIXED is fixed assets divided by total assets. ROA is return on asset. GROWTH is growth rate of sales. PUBLIC is the dummy variable with a value of 1 if the targets are listed, or 0 otherwise and OWN is dummy variable with a value of 1 if the targets are in same industrial group or 0 otherwise.

Note 2: Each industrial sector of the sample deal is defined based on Table 2.

Note 3: *** denotes significance at 1 percent level, ** denotes significance at 5 percent level and * denotes significance at 10 percent level.

(b)India

IN-IN M&A	Coefficient	Z-Value	OUT-IN M&A	Coefficient	Z-Value
SIZE	0.000	0.000	SIZE	0.002	0.640
MBR	0.001	1.210	MBR	0.003	0.760
CASH	▲ 0.003	▲ 0.010	CASH	▲ 0.011	▲ 0.200
ROA	▲ 0.066	▲ 0.780	ROA	0.114 *	2.050
GROWTH	▲ 0.009	▲ 0.540	GROWTH	▲ 0.024	▲ 1.190
PUBLIC	▲ 0.023 **	▲ 2.240	PUBLIC	0.007	0.620
OWN	0.020 *	1.780	OWN	0.002	0.150
Year_1	(dropped)		Year_1	(dropped)	
Year_2	▲ 0.020	▲ 1.350	Year_2	▲ 0.018	▲ 0.930
Year_3	▲ 0.004	▲ 0.250	Year_3	0.002	0.100
Year_4	▲ 0.022	▲ 1.260	Year_4	▲ 0.007	▲ 0.440
Year_5	0.001	0.090	Year_5	▲ 0.002	▲ 0.150
Constant	0.046 *	1.830	Constant	▲ 0.012	▲ 0.410
Number of Firms	163		Number of Firms		99
Adj R-squared	0.007		Adj R-squared		0.069

Note 1: Ordinary least squares regression of the acquirer's three day cumulative abnormal return on the on the following variables. SIZE1 and SIZE2 are the logarithm of total assets in terms of local currency and US dollar, respectively. MBR is book value of total liability plus market value of capital divided by total assets. CASH is cash reserve divided by total assets. FIXED is fixed assets divided by total assets. ROA is return on asset. GROWTH is growth rate of sales. PUBLIC is the dummy variable with a value of 1 if the targets are listed, or 0 otherwise and OWN is dummy variable with a value of 1 if the targets are in same industrial group or 0 otherwise.

Note 2: *** denotes significance at 1 percent level, ** denotes significance at 5 percent level and * denotes significance at 10 percent level

VI. Discussion

In summary, our empirical results basically support the hypotheses of this paper. Specifically, cash-rich firms are targeted in China and India as is generally done in the industrialized countries. Cross-border acquisition statistically records higher cumulative abnormal returns than domestic acquisition. The shareholder's value is larger when the foreign acquirer purchased publicly unlisted targets. However, some hypotheses are not supported. The size of acquirer affects the shareholder's value in case of the Chinese domestic deals, but shareholders do not always obtain larger returns when the acquirer has high market book to ratio, i.e.,

growth opportunity.

We used cash reserves to total assets as a proxy of firm's internal fund in our first empirical study. This variable implies that when the ratio is high, the target has a room to improve productivity by acquisition. As confirmed in several literatures, this variable significantly influences an acquirer's decision. We found this empirical result more remarkable in China and India because both countries experienced approximately ten percent economic growth and state-owned firms also recorded high growth rate of their profits in recent years. Under the process of market oriented economic reforms, we found large number of firms are with ample internal funds and have rooms for reforms. Therefore, the government's recent pronouncement promoting acquisition is most likely to contribute to an improvement in the economic efficiency. Our empirical results also suggest that not only foreign investors, but domestic investors as well contributed to the improvement in cost efficiency in the industrial organization of China and India.

The second empirical analysis also supports the government's recent promotion of incoming investment policy. Contrary to acquisitions in the industrialized countries, there are still plenty of restrictions in purchasing and holding private equity in China and India. In addition, in both countries, government still holds majority of publicly listed shares. This study suggests that future deregulation of private equity transaction by foreigners will contribute to an improvement in industrial efficiency and enlarge the shareholder's value. On the other hand, the results also suggest that it would be difficult to improve the productivity of listed firms as long as governments remain the largest shareholders.

The third empirical analysis suggests that for China, domestic firms with high growth opportunity are good acquirers. This result has several implications. An acquisition by a firm with high growth opportunity implies that management of the targeted firm is influenced by managers of acquirers. Since an acquiring firm with high growth opportunity has better cost efficiency than the target, the acquisition can also contribute to an improvement of inefficient in China.

In the late 1990s, the dramatic increase in short-term investment in emerging countries triggered the financial crisis. Based on an analysis of the firm's micro deal data, however, our study reveals that the recent dramatic increase in acquisitions in transition economies does not worsen economic welfare .

VII. Concluding Remarks

Focusing on China and India, this paper examined the causes and consequences of acquisitions in a transition economy. We found evidence that cash-rich inefficient firms are targeted more frequently as similarly observed in the industrialized countries. Our analysis also showed that cross-border and other types

of acquisition contributed to an increase in shareholder's value. Based on the assumption that an increase in shareholder's value soon after the deal announcement reflects future overall corporate value, our results confirmed that the recent increase in acquisition contributed to an improvement in economic efficiency as the two countries pursue market oriented economic reforms.

This paper also verified the determinants of acquisitions and its effects on shareholder's value in a transition economy. Although our empirical analysis focused only on China and India, our findings have important implications on the other emerging countries in transition around the world. Future study needs to examine if countries with high growth rate, large amount of natural resources and energy exhibit similar characteristics as we found in our study of China and India. These studies must reflect how future inward investment promotional policy by acquisitions could increase efficiency.

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