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**THE EFFECT OF ACQUISITION  
ANNOUNCEMENTS ON SHAREHOLDERS'  
WEALTH: A MALAYSIAN EXPERIENCE**

**BY**

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BY

JAMILA WAHAB

A RESEARCH PAPER SUBMITTED IN PARTIAL  
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## ABSTRACT

This study examined the effect of acquisition announcements on shareholders' wealth in Malaysia for the period January 1999 to June 2003. The Event Study technique was adopted to gauge any abnormal returns arising as a result of the acquisition announcement. A sample of 58 acquiring and 13 target firms from different industries was used in this study. In the overall performance, we found that acquiring shareholders did not experience increases in wealth as a result of the acquisition announcement throughout the event study period. Shareholders of target firms did not gain in the pre-announcement period, but secured abnormal returns in the post-announcement period. The industry analysis indicated that the returns of target firms were not significantly different while those of the acquirers were. The target shareholders in the finance industry gained slightly at the expense of the acquiring shareholders. Shareholders of target firms in the properties industry made abnormal returns but the acquirers did not. Although acquiring firms in the industrial products industry did not record high gains, they were better off than target firms. The construction industry recorded higher returns for acquiring shareholders at the expense of the target firms. Acquiring firms in the technology industry made losses while shareholders in the plantation industry enjoyed little gains. The present study concluded that the semi-strong form of the efficient market hypothesis did not hold since shareholders were able to make abnormal returns after the acquisition announcement. In addition, the study revealed that acquiring firms did not gain whereas target firms gained in the post-announcement period implying the existence of a fairly active market for corporate control in Malaysia.

## ملخص البحث

يتناول هذا البحث بالدراسة أثر إعلانات الإقتناء على ثروة أصحاب الأسهم في ماليزيا وذلك في خلال الفترة ما بين يناير عام 1999 الى يونيو 2003. وتبنت البحث استخدام تقنية دراسة الحدث كطريقة لقياس أي عوائد غير عادي(شاذة) التي تظهر كنتيجة لإعلان الإقتناء. وتم انتخاب عينة مكونة من 58 شركات قامت بعملية الإقتناء 13 شركة كانت هدفا لعملية الإقتناء من قطاعات النشاطات الصناعيات المختلفة. و بناء على الأداء العامة عموما لم نجد هناك دلائل بتثير الى حدوث زيادة في ثروة أصحاب الأسهم في الشركات التي قامت بعملية الإقتناء نتيجة لإعلان الإقتناء وذلك في خلال فترة الدراسة كلة. وبالنسبة لأصحاب الأسهم في الشركات المستهدفة فلم يحررو أية مكاسب في فترة ما قبل إعلان الإقتناء، لكنهم تمكنوا من ضمان عوائد غير عادي(شاذة) وذلك في الفترة ما بعد إعلان الإقتناء. وأظهرت نتائج التحليل لقطاعات الصناعيات المختلفة أن عوائد الشركات المستهدفة لا تختلف بدرجة ملحوظة عن بعضها البعض بينما كانت عوائد الشركات الهادفة مختلفة عن بعضها البعض. وكسبت حاملو الأسهم في الشركات المستهدفة في قطاع صناعة المالية بدرجة بسيطة على حساب أصحاب الأسهم في الشركات الهادفة. كما كسبت أصحاب الأسهم في الشركات المستهدفة في قطاع صناعة العقارات عوائد غير عادي(شاذة) لكن حاملو الأسهم في الشركات الهادفة لم يكسبوا شيئا. وبالرغم من أن الشركات الهادفة في قطاعات صناعة المنتجات لم يسجلوا زيادات كبيرة في المكاسب، غير أن أحوالهم أحسن بكثير مقارنة بزملائهم في الشركات المستهدفة. وسجلت قطاع صناعة المنشآت عوائد مرتفعة لمالكي الأسهم في الشركات الهادفة على حساب مالكي الأسهم في الشركات المستهدفة. وسجلت الشركات الهادفة في قطاع صناعات التكنولوجيا خسائر كما ذهبت مكاسب قليلة إلى أولئك الذين في قطاعات صناعة المزروعات. واستنتجت الدراسة الحالية عدم ثبوت الفرضية الشكلية للسوق المسمى ب" شكل السوق الفعال شبه القوي" وذلك بسبب تمكن أصحاب الأسهم من كسب عوائد غير عادي(شاذة) بعد إعلان الإقتناء. وبالإضافة الى ذلك، فقد كشفت الدراسة على أن الشركات التي قامت بعملية الإقتناء لم تكسب منها بينما كسبت الشركات المستهدفة وذلك في فترة ما بعد الإعلان دلالة على وجود سوق نشطة نوعا ما للسيطرة على الشركات التجارية في ماليزيا.

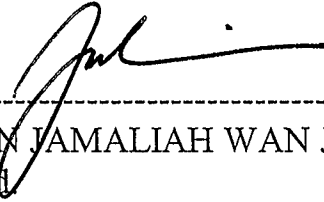
## APPROVAL PAGE

I certify that I have supervised and read this study and that in my opinion it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a research paper for the degree of Master of Science in Finance.



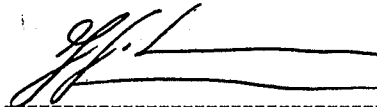
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**THE EFFECT OF ACQUISITION ANNOUNCEMENTS ON  
SHAREHOLDERS' WEALTH: A MALAYSIAN EXPERIENCE**

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*April 30, 2004*

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# DECLARATION

I hereby declare that this research paper is the result of my own investigations except where otherwise stated. Other sources are acknowledged by footnotes giving explicit references and a bibliography is appended.

Name: JAMILA WAHAB

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To My Family

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# CHAPTER 1

## 1.0 INTRODUCTION

### 1.1 Mergers and Acquisitions

Merger and Acquisition (M&A) activities have intensified throughout the world. The first wave of mergers occurred around the turn of the twentieth century in the advanced industrial nations of the world. These were characterized by large multi-firm consolidations. In the 1920s consolidations dominated the merger scene but were, however, spawned by a significant number of single firm acquisitions. This trend continued even after the Second World War (Marchildon, 1991). Mergers in those early periods were mainly horizontal mergers where firms acquired others in related businesses. On the contrary, mergers in the 1960s involved firms in disparate business operations in the form of conglomerate mergers (Cartwright and Cooper, 1992). In the past, mega mergers were an American phenomenon, however, this has changed with the deregulation and development of a common European economy. In Asia, mergers and acquisitions were adopted mainly for restructuring and downsizing due to ailing economies.

Merger and Acquisition activities are considered as rational financial and strategic alliances made in the best interests of the organization and its shareholders. Acquisitions reflect management's intended direction for a company. They can open up new growth opportunities and close off others. Through acquisitions a company can quickly enter new

markets, gain new technologies and obtain new talents. In short, an acquisition is a dramatic avenue to corporate growth.

An Acquisition is used for any transaction accruing between willing parties, in which the buyer acquires all or part of the assets of the seller. A merger is a combination of two corporations in which only one corporation survives and the merged corporation goes out of existence. A takeover is when one group takes control from another group. This can occur when the acquiring company acquires control over the assets of the target company either directly or indirectly through control of either the voting rights or the management of the latter (Gaughan, 2002). A takeover is also used when the management of the selling firm is an unwilling party in the combination of the companies. Specific forms of acquisitions include asset and stock acquisitions, statutory mergers and consolidations.

Throughout this paper, I will use the term mergers and acquisitions as though they are synonymous because in reality only a handful of genuine mergers occur in a year. Most of the transactions are acquisitions; therefore the distinction between the two terms is not important.

## **1.2 Mergers and Acquisitions in Malaysia and South East Asia**

The merger and acquisition scene in Malaysia have been relatively active since 1999. In 2002, the Securities Commission, the regulatory agency responsible for approving proposed takeovers and mergers in Malaysia, received and considered a total of 35 proposals. Although this number was slightly down from the 37 proposals in 2001 and



41 proposals in 2000, it was up from only 16 proposals in 1999. Generally, mergers and acquisitions in Malaysia can be categorized into three broad types: acquisitions arising out of the need for vertical integration, mergers as part of a consolidation exercise and overseas or cross-border acquisitions, Khoon (2003).

The role of the public sector is not to be overlooked in the Malaysian merger and acquisition scene. The government often plays the role of a catalyst within the private sector. This is because the government is often a substantial shareholder in a number of these companies, known as government-linked companies (GLCs). For example, in July 2001, the government, through its investment holding company Khazanah Nasional, mounted a takeover bid on United Engineers Malaysia (UEM). This triggered a flurry of mergers and acquisitions among other publicly listed companies in Malaysia.<sup>1</sup>

The government often takes the lead in industry consolidation, again through the use of government-linked companies. In early 2003, the government announced its intention to consolidate its various holdings maintained through government-linked companies in publicly listed plantation and property companies.<sup>2</sup>

Apart from being a direct participant, the government also plays an important role as a facilitator of mergers and acquisitions through its agencies and regulatory bodies. Often this is done via the introduction and implementation of friendly policies as well as the introduction of tax incentives for companies making acquisitions, particularly if these involve the takeover of a foreign company. Basically, the government is trying to encourage Malaysian companies to acquire companies overseas - a form of reverse

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<sup>1</sup> Euromoney, 2003.

<sup>2</sup> Ibid.

foreign direct investment. In the 2003 budget tabled last September, the government announced that Malaysian companies that acquire foreign-owned companies abroad would be granted annual allowances equivalent to 20% of the acquisition cost for five years if the objectives of the acquisitions are to acquire high technology for production within Malaysia, or to gain new export markets for local products.<sup>3</sup>

This new fiscal incentive will hopefully pave the way for a greater number of cross-border acquisitions by Malaysian companies. Some of the mergers and acquisitions taking place in Malaysia today are precursors to, or are necessitated by, industry or sector consolidation.<sup>4</sup>

Merger and Acquisition activity involving Malaysian companies will continue to grow in the coming years and be among the most robust in the region as they pursue strategic acquisitions abroad and consolidate locally. Merger and Acquisition deals from the Asia-Pacific region as a proportion of the global total have been rising steadily from 5% in 1998 to 17% in 2002.<sup>5</sup>

Todd Marin, managing director of JP Morgan's M&A practice in Asia-Pacific said that, "Global competitive pressures and the drive for economies of scale will always push companies to get larger, and a successful merger would drive others to form a competing entity of equal scale".

Data recently released by JP Morgan revealed that the percentage of cross-border acquisitions have increased to 59.8% of all announced merger and acquisition deals in the region for January to August 2003, from only 37.4% for 2002. A third of all deals

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<sup>3</sup> Ibid.

<sup>4</sup> Ibid.

<sup>5</sup> The Star Online, September 15, 2003.

were for acquisitions outside South-East Asia, up substantially from 12% in 2002. The percentage of cross-border acquisitions rose from only 37.4% in 2002 to 59.8% of all announced merger and acquisition deals in the region for January to August 2003. This has, therefore, made mergers and acquisitions more intriguing than ever.<sup>6</sup>

### **1.3 Rationale for Mergers and Acquisitions**

#### **1.3.1 Diversification**

One of the most common rationales for merger and acquisition programs in the 1990s was diversification. Since survival is ultimately the key objective of a business, making sure that the company has market opportunities in more than one segment of the industry is a prudent strategy to pursue. Engineering a new market or business is certainly a risky undertaking. Each potential buyer will have to decide whether starting a new operation or acquiring another company with the desired expertise is the proper method of diversifying

In practice, companies often acquire others in order to diversify their operations so as to enhance profitability or reduce risk. On the contrary, proponents of perfect capital markets think that diversification is of no use to shareholders, since the latter may diversify their portfolios more cheaply. The main rationale is for management to enter new industries that are more profitable than acquiring firms in the current industry. In the Malaysian experience, Fauzias and Takiah (1986) concluded in a financial survey that about 52% of acquisitions are for diversification purposes.

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<sup>6</sup> Ibid.

However, some researchers have criticized diversification as a motive for merger and acquisition activity. Most of them are of the view that it is difficult to manage firms in different industries especially where there are dissimilarities in corporate cultures. Some researchers have refuted the merger gains associated with diversification. Using a large sample of firms over the period 1986 to 1991 in the US, Berger and Ofek (1995) found that diversification resulted in a loss of firm value averaging between 13 to 15%. Ghani (1999) also concluded that vertical mergers seem to bring out the best performance followed by other mergers where processes, markets, products etc are related. Conglomerate mergers, which seem to dominate the Malaysian merger scene, fare the worst.

### **1.3.2 Growth**

Most companies have growth as a key objective and an acquisition provides a way to achieve rapid growth. It allows the buyer to acquire needed resources or utilize existing resources in an efficient manner. Of course, making an acquisition for the objective of growth assumes that growth is desirable in the first place.

Another reason why companies merge or acquire others is to sustain growth. The target may be in a growth sector, which seems attractive to the acquiring firms. In addition, others find it cheaper to acquire growth than to develop into new areas (Cooke, 1986). Companies seeking to expand are faced with a choice between internal growth and growth through mergers and acquisitions. Internal growth may be a slow process whereas growth through mergers and acquisitions may be much more rapid. Some companies consider mergers as instruments of growth when they want to

expand to new geographic regions. This may be particularly true for international expansion where there are so many market uncertainties. Many companies are seeking geographic diversification to reduce the risk of a downturn in a given area. Although start-ups are still very common, one way to have instant market participation in a new geographic area is to purchase a local player. This is certainly a more rapid form of market entry, and can be less costly, if done properly.

### **1.3.3 Operating Synergy**

Synergy can be simply defined as the increase in a firm's value due to two firms merging or, rather one taking over the other. The basis of synergy is that operating economies of scale can be achieved because existing firms in the industry are operating below capacity. The above economies of scale are more likely to be achieved in horizontal mergers rather than vertical integration or conglomerates. Some empirical research even supports the assertion that mergers and acquisitions are used to achieve operating economies (Lichtenberg & Siegel, 1987). In contrast, financial synergy is more likely to be achieved in conglomerates. If the cash flows of two merging entities are not perfectly correlated, the risk of insolvency may be reduced.

### **1.3.4 Financial Synergy**

This refers to the impact of a corporate merger or acquisition on the cost of capital to the acquiring firm. Finance theory proposes that corporate combinations should lower the cost of capital. Mergers and acquisitions can reduce the insolvency risk if the

firm's cash flow streams are not perfectly correlated. If the merger or acquisition lowers the volatility of a firm's cash flow, suppliers of capital consider the firm less risky. The risk of bankruptcy will be presumably reduced given the fact that wide swings up and down in a combined firm's cash flow would be less likely thus making it impossible for the firm to become technically insolvent. Higgins and Schall (1975) have referred to this concept as the debt coinsurance. They said that if the correlation of the income streams of two firms is less than perfectly positively correlated, the bankruptcy risk associated with the combination of the two firms may be reduced. They reiterated that the debt coinsurance effect does not create any new value but merely transfers wealth from common stockholders to debt holders. Merger and acquisitions programs carried out for financial motives are not uncommon in the conglomerate merger type.

### **1.3.5 Hubris Hypothesis**

Roll (1986) proposed an interesting hypothesis known as the hubris hypothesis of takeovers. This hypothesis implies that managers seek to acquire a firm for their own personal motives and that the pure economic gains to the acquiring firms are the sole motivation or the primary motivation in merger and acquisition programs. He used this hypothesis to explain why managers might pay a premium for a firm that the market has already valued correctly. He said that the pride of management allows them to believe that their valuation is superior to that of the market.

### **1.3.6 Monopolistic Theory**

This theory describes mergers and acquisitions as programs planned by the management of stronger firms in an industry to acquire smaller ones to form a formidable entity. This gives them the monopoly to control price and output and thereby to make abnormal profits. A study by Stigler (1950) suggests that earlier mergers that occurred in the US were mainly for monopoly power. In contrast to Livermore (1935), who concluded that mergers enhance efficiencies, Stigler (1950) stressed the potential negative aspects of mergers. However, Utton (1972) in testing the hypothesis adopted by Stigler (1950) in the UK concluded that mergers in the UK during the early twentieth century were motivated by monopolistic power, a time where this was being curbed in the US due to the enactment of the antitrust laws. This theory has also been rejected as a source of gain in merger and acquisition by Eckbo (1983) and Stillman (1983). Acquisition programs carried out for the sole reason of dominating the market or a particular industry are very common in horizontal mergers.

### **1.3.7 Vertical Integration**

This type of acquisition is more of a defensive acquisition than the others. One form of vertical integration is buying a firm that supplies you with services or products. Acquiring a supplier can guarantee a source of supply of some product or service and eliminate the margin that the supplier has been earning. The other type of vertical integration is purchasing a customer. Buying a customer can guarantee an outlet for

your service, or product, and enhance your profit by eliminating the margin charged by the customer.

### **1.3.8 Stock Market Discipline Hypothesis**

Manne (1965) was the first to explain this hypothesis and he suggested proxy fights, direct share purchase and mergers as the techniques for taking over control. It was later reiterated by Jensen and Ruback (1983), who suggested that a merger is a good mechanism to replace inefficient managements with efficient ones. However, Jensen (1986) contends that an effective replacement can occur only in the same industry since skills are not transferable between industries. He argued that takeovers or the threat of takeovers provide an efficient mechanism for ensuring that existing managements live up to some standards of efficiency. The hypothesis states that there is a direct relationship between a firm's managerial efficiency and the market value of its stock prices. Therefore, if a firm consistently performs below its expected potential, a fact which reflects in its share values, it will be purchased by another company with more aggressive and innovative strategies aimed at increasing profits and, therefore, the market price of its shares. He, however, mentioned the need for the existence of developed and efficient capital markets for this discipline mechanism to be effective. This merger and acquisition motive ensures that management efficiency is achieved as well as protecting the rights of minority shareholders. If this is a motive for mergers and acquisitions, then target firms would have earned negative returns prior to the event date.