

Ownership Structure, Motives and Corporate Takeover Performance of Malaysian Public Listed Firms

Saw-Imm Song

Universiti Teknologi MARA, Kampus Samarahan

Ruhani Ali

Universiti Sains Malaysia

Subramaniam Pillay

Universiti Sains Malaysia

Abstract: This study examines the impact of ownership structure and motives for takeover on firm performance, with reference to 52 large and fully integrated acquisitions (100 per cent purchase stake) by Malaysian public listed firms from 1990 to 1999. The results shows that the bidders underperformed before the takeovers compared to the benchmark firms using a matched sample by their asset size and principal activities before the takeover. Bidders' post-takeover operating cash flow returns have significantly improved compared to their matched counterparts. We find that concentrated ownership has a significant positive impact on the post-takeover performance and *vice versa* for diffused ownership. This study also shows that if the substantial shareholders or the directors of the bidders personally own the targets, the impact on the post-takeover performance is significantly negative. The motives for managerial, financial or operational synergies however, do not explain the variations in post-takeover performance.

Keywords: Corporate takeovers, performance, cash flow returns, ownership structure, motives, Malaysia

1. Introduction

Previous market-based studies consistently reported that bidders lose or do not gain upon announcement of a takeover. The average negative reaction implies that investors expect future performance of the combined firms will not be improved. In the longer term, some highlight that the bidders lose even more Franks and Harris 1989; Agrawal *et al.* 1992). Conflicting results are, however, found in accounting-based studies in assessing the post-M&A performance. Healy *et al.* (1992), Abdul Rahman (2004) and Powell and Stark (2005) find positive cash flow returns as a result of a merger while Ravenscraft and Scherer (1989) and Ghosh (2001) who examined earnings performance have concluded that merged firms have no operating improvement. In Malaysia, similar findings were found by Mat Nor and Mohd Zin (1996) and Ali (1998).

Given the negative reactions to the M&A announcements and inconclusive findings from the accounting-based studies as highlighted in the literature, the motives for M&A to

Corresponding Author: Saw-Imm Song, UiTM Kampus Samarahan, Jalan Meranek
94300 Kota Samarahan, Sarawak

Email: songsi@tm.net.my

justify the *ex ante* performance remain debatable. Thus, this study seeks to explore the possible factors that may cause the variations of **post-takeover** performance by looking into three groups of variables namely ownership variables, takeover motives, and control variables such as takeover premiums, method of payment and relative size of bidder to target.

Most studies on takeovers in developed countries highlight agency conflict between shareholders and their managers (Morck *et al.* 1988; McConnell and Servaes 1990) where managers try to maximise their own utility. However, Claessens *et al.* (1999) contend that the primary issue for large corporations in East Asia is limiting expropriation of minority shareholders by controlling shareholders, rather than restricting empire building by unaccountable managers. Thus, this study attempts to find out whether concentrated ownership or diffused ownership will have an impact on post-takeover performance. In addition, the directors or substantial shareholders' equity stake in targets is also being studied so as to find out if there is any expropriation by the directors or substantial shareholders in the bidding firms. The takeover motives, namely for operational, managerial or financial, on the other hand, are to infer any possible sources of value creation or possible agency conflicts that could have a profound impact on the combined firms.

This study uses 52 large and fully integrated acquisitions (100 per cent purchase stake) by the public listed firms in Malaysia from 1990 to 1999. The results shows that the bidders underperformed before the takeovers compared to the benchmark firms using a matched sample by their assets size and principal activities before the takeover. Bidders' post-takeover operating cash flow returns significantly improved compared to their matched counterparts.

The study also found that concentrated ownership has a significant positive impact on the post-takeover performance and *vice versa* for diffused ownership. However, we also found that about one-third of the targets were owned by the substantial shareholders or the directors of the bidders. Bidders and targets with such ownership characteristics have significant negative impact on the post-takeover performance.

The remaining part of this paper is presented in four sections. The next section is on related literature, followed by methodology. Section 4 highlights the findings and Section 5 concludes.

2. Literature

2.1 Ownership

Generally, ownership structure can be classified into diffused and concentrated ownership. Many concerns have been raised as a dispersed ownership structure will be too costly for the minority shareholders to exert any control on the managers. It is believed that managers, being professional and propertyless, would act for their self-interest rather than maximising the wealth of their shareholders. Thus, the conflict of interests between managers and owners arises.

Jensen and Meckling (1976) concede that concentration of ownership would be beneficial to corporations as large shareholdings allow for greater monitoring of managers. It also reduces transaction costs in negotiating and enforcing corporate contracts with various stakeholders. Similarly, Morck *et al.* (1988) suggest that the absence of separation between ownership and control reduces conflicts of interest and this increases shareholder value.

Most Asian corporations have very high concentration of ownership. For instance, at 20 per cent cut-off for voting rights of the largest shareholders, 67.2 per cent of the Malaysian corporations are owned by families (Claessens *et al.* 1999). La-Porta *et al.* (1998) found that three largest shareholders owned some 54 per cent of the shares of the ten largest non-financial private firms and 46 per cent of the shares of the ten largest firms in Malaysia. Given such a high concentration of ownership, there is rarely any hostile takeover in disciplining the controlling parties. Furthermore, the separation of management from ownership control is rare, with management of two-thirds of the firms related to the controlling owners.

Recent research by Claessens *et al.* (1999) and La Porta *et al.* (1998), Lemmon and Lins (2003) and Chang (2003) have pointed to the fact that the agency problem in East Asia is expropriation of minority shareholders by the controlling owners rather than conflict of interest between managers and dispersed shareholders. The severity of agency problem in East Asia is complicated by the use of pyramidal or cross-holding by controlling owners. 39.3 per cent and 14.9 per cent of the controlling shareholders of the public listed companies (PLCs) in Malaysia gain effective control through pyramidal structure and cross-holdings, respectively (Claessens *et al.* 1999). This type of ownership structure would enable the controlling owners to exercise effective control over a company despite owning relatively few of its cash flow rights. When controlling owners have rights in excess of their proportionate ownership (control right > cash flow right), the consumption of private benefits of control is especially likely as this type of ownership structure reduces cash flow incentive alignment and increases the potential for managerial entrenchment (Claessens *et al.* 1999).

However, Morck and Yeung (2004) highlights that in countries with weak institutions (education system, courts, financial regulators, and organ of government), firms with family ownership and pyramidal control should be more desirable than dispersed ownership. This is because in a weak legal protection environment for the shareholders, professional managers may be deeply unreliable and opportunistic. They may simply loot the firm, with no concern for its future or for the wealth of its shareholders.

Another ownership characteristic such as bidder's equity stakes in the target (toehold, subsidiaries or associate companies in Malaysia) is one of the variables that has generated much interest in the literature. However, since the majority of the targets in this study are from non-public listed firms and only those targets that are fully integrated into the bidders' firm (bidders acquire 100 per cent equity stakes in targets) are considered in this study, the more relevant variables of interest is the directors or substantial shareholders' personal equity stakes in the targets. In the corporate governance model, the board of directors is formed to resolve the agency problem. However, this move is arguable as the effectiveness of these directors is questionable since most of the time, their interests are much more closely tied to those of managers/executive directors (Davis *et al.* 1991). In Malaysia, given the very high concentrated ownership, in many cases, the directors are also the controlling shareholders or they are related to the controlling shareholders. The idea that board ownership and concentrated shareholding protect minority shareholders is debatable. Instead, the board's decision in takeovers may not maximise, and may even diminish, shareholders' wealth by tunnelling out bidder's resources at the expense of the minority shareholders. One way of doing this is by acquiring the targets that are owned by them and pay a very high premium in acquiring the targets.

2.2 Motives for M&A

The motives for mergers and acquisitions are often complex and present a problem of classification. There is no single reason for a takeover or merger but rather a number of reasons, which are sometimes contradicting and complementing each other.

First, the **efficiency theory** (Mueller 1995; Trautwein 1990) views mergers or acquisitions as being planned and executed to achieve synergies. If management of A is more efficient than B, after company A buys over B, the efficiency of B should be brought up to the level of A. Efficiency represents a real gain in combining both companies' resources as there is a possibility of lowering per unit cost, increase bargaining power with suppliers or customers. In general, three types of synergies are highlighted: (i) the financial synergies, (ii) operational synergies, and (iii) managerial synergies (Sudarsanam *et al.* 1996). These synergies may allow the combined company to achieve a positive net acquisition value or improve performance.

In contrast to the efficiency theory, the second theory highlights that managers may pursue M&A in order to maximise their **own utility (empire building)** instead of maximising shareholders' value.¹ This is inline with the findings by Amihud and Lev (1981) that managers would pursue unrelated diversification even if it hurts shareholders. For instance, if managers themselves are not properly diversified, they would diversify the holdings of the firm to reduce the risk to their human capital even when diversification offers few or no benefit to shareholders. Shleifer and Vishny (1990) also highlight that when poor performance of the firm threatens a manager's job, he has an incentive to enter new businesses at which he might be better off. As a result, managers might be willing to overpay for targets outside the bidding firm's industry, thus reducing the wealth of their shareholders.

The next popular theory is the **Process Theory** which argues that sometimes, strategic decisions are not comprehensively thought out rational choices. This is due to for example, limited information processing capabilities (Duhaime and Schwenk 1985) on acquisition and divestment decisions and Hubris Hypothesis (Roll 1986) which argues that managers' expectations are systematically erroneous with an upward bias or over optimism. In the process, they convince themselves that the valuation they make is right and the market does not reflect the full economic value of the combined firm. Therefore, even when synergy is absent, they would still engage in the takeovers. As a result, their over-confidence about the deal makes them pay too much. These over-inflated egos ultimately cause the M&A to fail. In the Malaysian context, Ali and Gupta (1999) have examined the determinants of takeovers by comparing the mean values of the financial characteristics of the bidders, targets, control bidders and control targets before and after takeovers. They infer that Malaysian takeovers during their study period are motivated by size, growth, profit consideration and a balanced leverage. As the majority of the transactions were conglomerate-type of takeovers, they conclude that synergy theory does not appear to apply in their findings.

From the various motives highlighted above, it can be concluded that managerial motives for takeovers can be divided into good and bad motives. Good motives such as motives for

¹ This approach has its roots in the original study on the separation of ownership and control in the corporation. See also Berle and Means (1932), Marris (1964), Williamson (1964) and Mueller (1969) on the various managerial theories of the firms.

efficiency enhance the value of the firms or have 'convergence of interest' between shareholders and the controlling parties and managers. Bad motives are pursued by managers or the controlling parties to fulfil their self-interest such as described in the empire building theory and process theory. These bad motives seem to be more plausible as observed by the negative gains suffered by bidders upon the announcements of takeovers. However, it is difficult to observe or make direct inference on these bad motives. Thus, this study only focuses on the good motive, namely the efficiency motives by looking into the sources of value creation from managerial synergies, operational synergies, and financial synergies.

2.3 Control Variables

Pre-takeover control adjusted cash flow returns, relative size of bidders to targets, method of payment and premium paid are used as control variables as they may have an impact on takeover performance as in previous studies.

Healy *et al* (1992) found that there is a positive effect of pre-takeover control-adjusted cash flow returns on post takeover control-adjusted cash flow return. Thus, pre-takeover control-adjusted cash flow returns is used to capture any correlation in cash flow returns between the pre- and post takeover years.

The relative size of target to bidder and the method of payment are found to have an impact on the post-takeover performance in the literature (Moeller *et al.* 2004). As such they are also used as control variables in this study. The relative size is an indication of potential economies of scale or scope that could benefit the combined firm. If the target size is bigger, then the impact of the combination will be more significant. Jarrell and Poulsen (1989) and Loderer and Martin (1992) found a positive relationship between the relative target size and the cumulative abnormal returns of the bidder upon announcement of the combination.

Several studies have looked into the relationship between the method of payment and bidder's returns. Myers and Majluf (1984) contend that if the management of the bidding firm has superior inside information that its assets are undervalued, a cash-financed acquisition is more likely to happen. This is a positive signal sent by the bidder to the market that the bidder's existing assets are undervalued.

On the other hand, in a study by Chang (1998) on the returns of bidders on the acquisition of privately-held targets, he found that in stock offers, bidders experience positive abnormal returns, which is in contrast to the negative abnormal returns typically found in acquiring a publicly traded target. He contends that this is due to the creation of large blockholders in the bidding firm from the target if common shares are issued to the target shareholders. These blockholders can serve as an effective monitor of managerial performance or will facilitate takeovers (Shleifer and Vishny, 1986). The willingness of the target shareholder to take large positions in a firm also conveys favourable information about the firm. Their findings are also supported by Fuller *et al.* (2002) and Abdul Rahman (2002).

Generally a cash offer gives better results in assessing the post-takeover performance for public listed firms (Megginson *et al.* 2004; Loughan and Vijh 1997; Sudarsanam *et al.* 1996). As highlighted by Jensen and Meckling (1976) and Jensen (1986), equity issues are non-bonded funds. Thus, investors perceive equity issue as a vehicle for managers to increase free cash flow and use the fund to increase their own utility rather than to distribute it to the

shareholders. As a result, the reaction to takeovers financed by equity results in negative response to share prices.

When a bidder takes over a target, very often, it needs to pay a premium, which is in excess of the value of the company. This is to induce the existing shareholders to relinquish their ownership so that it can gain control of the corporation. Thus, it is not only acquiring the stock but also the right to control and change the direction of the company. The premiums paid also represent the expected synergies that the bidder will gain if the two firms are combined. The other rationale for control premiums is that a controlling shareholder will be able to expropriate private benefits from the firm at the expense of minority shareholders such as excess compensation by "tunnelling" assets out of the corporation (Johnson *et al.* 2000). Roll (1986) and Sirower (1997), however, contend that the higher the premiums, the greater is the value destruction from the acquisition strategy, unless, the motive for M&A is a carefully thought out strategy and is driven by synergies that must be translated into performance gains beyond those that are already expected.

3. Methodology

This section discusses variable definitions, model specifications, and sample used in this study.

3.1 Variable Definitions

The variables used in this study are discussed as follows:

3.1.1 Accounting-based Performance

In studies involving accounting-based performance measures, net income has often been used. However, this measure is distorted by the choice of financing (debt or equity) and accounting method used for takeover (pooling or purchase method). Thus, to overcome this distortion, following Healy *et al.* (1992), Switzer (1996) and Megginson *et al.* (2004), the operating performance in any year was measured by income before taxes and extraordinary items, plus depreciation and total interest expenses. The adjusted income was cash flow-based, that is, this measure will be unaffected by depreciation, or the type of financing used to fund the takeover. Therefore, the measure should provide an accurate indicator of efficiency changes as a result of the combination and thus was used in this study. To compare performance across firms, the operating performance was deflated by the book value of total assets at the beginning of the relevant year. Book value was used as the bulk of the sample was from private companies that do not possess market value information.

In order to assess the real gains from M&A, control benchmarks are often used. Healy *et al.* (1992) and Switzer (1996) used median industry performance as their control. However, Ghosh (2001) highlighted a consistent difference in size between acquiring firms and industry median firms. Larger firms tend to perform better than smaller firms because of this systematic or permanent factor. He suggested that a better method would be by comparing the pre- and post-acquisition performance of merging firms relative to control firms matched on pre-acquisition performance and size. Matched-firm comparisons were also used by Mueller (1986), Barber and Lyon (1996), Ali (1998) and Abdul Rahman and Limmack

(2004).

In this study, control firms were matched on the basis of their principal activities following a 3-digit SIC code published by Dun and Bradstreets (1996) and size measured by total assets of the bidder, at the end of the year prior to takeover. If the 3-digit SIC code was not available for the bidder, it was matched by the principal activities reported in the annual companies handbook. If such principal activities are unique and a suitable match cannot be found, then the control firm will be matched based on sub sector classification as reported in the KLSE statistics (KLSE, various issues). The matching criteria imply that the bidders are trying to be at par or outperform their counterparts in the same business or similar size by acquiring another company. Thus, the combined firms' performance should be at par or better than the control firm following the takeover. Changes in operating performance resulting from a takeover are evaluated by comparing the post-takeover performance with the pre-takeover benchmark. However, as noted by Healy *et al.* (1992) that 'some of the difference between pre-merger and post-merger performance could be due to economy wide and industry factors, or to a continuation of firm-specific performance before the merger'. Thus, they have resorted to abnormal industry-adjusted performance of the target and bidding firms as the benchmark. In the case of the current study, the appropriate benchmark would be the control-firm adjusted-performance.

The pre-takeover benchmark was obtained by using the performance data of the bidding firms before the takeover deflated by the sum of its asset value:

$$CFR_i = \frac{CF_{B,i}}{Asset_{B,i}} \quad (3.1)$$

where the cash flow (CF) measures the adjusted income as defined earlier and B denotes "bidder". CFR denotes cash flow returns on assets for the firm.

The pre-takeover control firms were matched by the size and principal activities of the bidding firms. Their performance was also computed by using the cash flow returns similar to the bidders and was denoted as $CFR_{C,i}$. The returns were then averaged over the three years prior to acquisition. Thus, the pre-takeover performance or the control-adjusted cash flow return before takeover (ACFRPRE) is the difference between the average $CFR_{i,pre}$ and average $CFR_{C,i,pre}$:

$$ACFRPRE_i = \text{Average } CFR_{i,pre} - \text{Average } CFR_{C,i,pre} \quad (3.2)$$

Post-takeover values are based on averaging the data for four year for the combined firms, so that it has a longer period to capture the effects of takeover. A similar adjustment was made for control firm performance. The post-takeover performance or the control-adjusted cash flow returns (ACFRPOST) is the difference between the average $CFR_{i,post}$ and average $CFR_{C,i,post}$:

$$ACFRPOST_i = \text{Average } CFR_{i,post} - \text{Average } CFR_{C,i,post} \quad (3.3)$$

3.1.2 Ownership and Classification

Ownership in this study was classified into two: concentrated and diffused ownership. The cut-off point for diffused ownership was at 20 per cent (no shareholders control more than 20 per cent of the voting rights of the corporations), while for concentrated ownership it was more than 20 per cent. This is because even though 33 per cent voting power will in fact give de facto control, in reality, a 15-25 per cent control over voting rights is sufficient for control (Loh 1996). La-Porta *et al.* (1999) consider 20 per cent of voting right (direct or indirect) as enough to give effective control of a company. As for the directors or largest shareholders' ownership in target, a dummy value 1 was assigned the variable if it was found that the bidders' directors or its substantial shareholders have equity ownership in the target, otherwise a 0 was assigned.

3.1.3 Motives

Operational synergy refers to the bidders that acquire target from related business (Sudarsanam *et al.* 1996). Relatedness of business refers to a scenario where the bidder and target are operating in the same industry with a very high overlap in their principal activities as described in the KLSE Annual Companies Handbooks or 'Circular to Shareholders' documents. This variable is a proxy for potential economies of scale and scope and market power that will benefit the bidder after taking over the target.

If the profits of the targets are negative before takeover, the takeover implies that bidders are trying to exercise their managerial expertise to transform the target company. The targets' average three-year net income before the takeover is used to infer the performance of the target and bidder's managerial motive. The potential disciplinary impact of bidder on target's management should enhance the performance of the combined firms later.

Financial synergy is measured by the relative debt/equity ratio of bidder to target. If the bidders and targets are having substantial differences in the level of debt, the inferred motive for the takeover is to tap the unused debt capacity or as a cheap cost of financing.

3.1.4 Control variables

The pre-takeover control adjusted cash flow return (ACFRPRE) is used to capture any correlation in cash flow returns between the pre- and post-takeover years. The coefficient of ACFRPRE measures the effect of the pre-takeover performance on post-takeover returns. The intercept α is therefore independent of pre-merger returns.

The relative size of bidder to target is measured by the asset size of bidder to target one year before the announcement date. The method of payment uses a dummy variable whereby if the payment involves cash, 1 is assigned to the value, 0 for otherwise.

The computation of premiums paid in this study follows the measure used by Palia (1993) and Shawky *et al.* (1996) who used the ratio of the offer price divided by the book value of the target. This measure was used as most targets in the sample involved non-public listed firms. This ratio gives an indication of how many times the bidder is willing to pay for the target firm over its book value.

Table 1 summarises the variables used in this study:

Table 1. Variables used

	Variable	Definition of measurement	Proxy for	Literature
Symbol				
ACFRPOST	Name Control-adjusted cash flow returns after takeover	The difference between the $CFR_{i, post}$ and $CFR_{ci, post}$	Performance	Healy <i>et al.</i> (1992), Switzer (1996).
Motives				
OS	Operational synergies	Dummy = 1 if bidder and target operate in the same or related industry, 0 = otherwise)	Potential for economies of scale and scope, enhanced market power.	Trautwein (1990) Mueller (1995), Sudarsanam <i>et al.</i> (1996).
MS	Managerial synergies	Average 3-year pre-takeover net income of the target.	Potential disciplinary impact of bidder on target's management.	
FS	Financial synergies	Ratio of debt/equity between bidder and target.	Potential for cheaper capital.	
Bidder's Ownership Structure				
DIFF_OWN	Diffused/dispersed ownership	If no one holds more than 20% of the corporation's shares. (Dummy =1, otherwise = 0)	Managerial entrenchment/alignment	Jensen & Meckling (1976), Mock <i>et al.</i> (1988) La-Porta <i>et al.</i> (1999), Claessens <i>et al.</i> (1999)
DIRO	Director or largest shareholder's ownership in target	Bidder's director or its largest shareholders personal equity stakes in target (Dummy =1, otherwise = 0)	Managerial entrenchment/alignment	
Control Variables				
ACFRPRE	Control-adjusted cash flow returns before takeover	The difference between the $CFR_{i, pre}$ and $CFR_{ci, pre}$.	Performance	Healy <i>et al.</i> (1992), Switzer (1996).

Table 1 continued

	Variable	Definition of measurement	Proxy for	Literature
RSIZE	Relative size of target to bidder	Total assets of bidder/Total assets of targets prior to the announcement date.	Impact of target on bidder	Jarrell & Poulsen, (1989), Loderer & Martin (1992), Seth (1990), Moeller <i>et al.</i> (2004).
MPAY	Method of payment	Dummy = 1 for payment involves cash, 0 otherwise.	Asymmetry of information and signalling	Myers & Majluf (1984).
PREM	Premiums paid	Purchase price/ Book value of targets	Potential hubris and expropriation/ synergies.	Palia(1993), Shawky <i>et al.</i> 1996), Roll(1984), Sirower(1997)

3.2 Model Specification

In this study, ACFRPOST or proxy for post operating performance was used as the dependent variable. Multiple regression analysis was used to assess the effect of ownership structure and motives on the post-takeover performance, controlling for premiums paid, relative size of bidder to target and method of payment. The base model for the analysis was as follows:

Post-takeover performance = $f(\text{Ownership structure, Motives, control variables})$

Mathematically, the model is expressed as follows:

$$\text{ACFRPOST}_i = \alpha + \beta_1 \text{DIFF_OWN}_i + \beta_2 \text{DIRO}_i + \beta_3 \text{OS}_i + \beta_4 \text{MS}_i + \beta_5 \text{FS}_i + \beta_6 \text{ACFRPRE}_i + \beta_7 \text{RSIZE}_i + \beta_8 \text{MPAY}_i + \beta_9 \text{PREM}_i + \epsilon_i \quad (3.4)$$

Table 2 summarises the directions of the *a priori* expectations as discussed earlier in the literature. ACFRPOST is the post-merger performance measured by the difference between the averages of $\text{CFR}_{i, \text{post}}$ and $\text{CFR}_{\text{Ci, post}}$ respectively as in Eqn. 3. The α is expected to have positive sign as the pre-and post-performance should be highly correlated. The DIFF_OWN and DIRO are expected to have negative signs as these two factors have greater potential for managers to expropriate. The synergy variables namely OS, FS, and MS are expected to have positive signs.

The coefficient of ACFRPRE is expected to have a positive sign as the pre-takeover performance will have a positive impact on the post-takeover performance. The sign for RSIZE is expected to be negative as the bigger the target's size, the greater the impact on the combined firms. The MPAY is expected to have a negative sign as the privately-held target shareholders will potentially become blockholders in the combined companies if the takeover is financed by equity and thus better monitoring on the management. Lastly, the premium variable, PREM is expected to have a positive sign. This is because the higher the premium, the higher will be the expected benefits that the bidder can get as a result of the combination.

Table 2. Expected signs of the determinants of post-takeover performance

Variable	Coefficient	Sign
CONSTANT	α	+
DIFF_OWN	β_2	-
DIRO	β_3	-
OS	β_4	+
DUM_MS1	β_5	+
LNRA_FS1	β_6	+
ACFRPRE	β_1	+
LNRSIZE	β_7	-
MPAY	β_8	-
LNPREM	β_9	+

3.3 Data

Initial M&A announcement list was identified from the *Investors Digest* published by KLSE (various issues). The actual combinations of the firms were confirmed by checking through the Companies Announcement Files, Annual Reports and the *KLSE Annual Companies Handbook*. Financial data for the quoted firms were then obtained from the *KLSE Annual Companies Handbook* while the non-quoted targets were obtained from the Companies Announcement Files of the bidders. The pre-takeover performance data were collected for three years prior to takeover announcement and 4 years for the post-takeover performance. Thus, the data collected spread from 1987 to 2003, covering 17 years. If the bidders were involved in a few takeovers during the period of study, only the latest takeover was included. The second takeover was included in the sample only if it occurred after four years from the first takeover.

Ownership data were obtained one year prior to M&A. If the dominant owner was a company, the owner of the dominant owner was traced further in order to get the ultimate owner. If the ownership chain included any non-public listed companies, the records kept by the Companies Commission of Malaysia (CCM, formally Registrar of Companies) were used. Thus, the ownership data included the direct and indirect interests of the dominant shareholders in the corporate in order to give a more accurate picture of corporate control in Malaysia.

Takeover in this study refers to a takeover bid which gives the buyer a controlling stake, that is, 33 per cent of voting rights of a company as provided for under the Malaysian Code of Takeovers and Mergers, 1998. Only successful takeovers have been used in the analysis. The sample included public listed targets with a more than 33.3 per cent purchase stake. This is because in takeovers, controls must exceed 33 per cent of the voting right with the assumption that 33 per cent is sufficient to give control or to result in a change in control.

As for the non-public listed firms, which were relatively smaller, only those involving 100 per cent acquisition stakes or fully integrated target firms were included. Acquisitions of subsidiaries (which bidders already own more than 50 percent stakes) or associate companies (which bidders already owned more than 20 per cent stakes) were excluded as including these types of acquisitions might contaminate the results. The targets should have

more than RM20 million in assets as too small a target would not have any significant impact on the bidders (Abdul Rahman 2002; Seth 1990). Furthermore, the Code of Takeover and Mergers (1998) only includes private limited companies having shareholders' fund of RM10m or more and where the purchase consideration is not less than RM20m (Loh 1996).

The final sample excluded banks and other financial institution in order to improve comparability of balance sheet and income data. Furthermore these firms are highly regulated and have very high degree of government intervention and thus should be treated separately. Public utilities were also excluded for the same reason.

By scrutinising through the companies annual reports, it was also found that some M&A deals were not reported through the *Investors Digest*. Nevertheless, the deals were also included in the sample if it was found in the annual reports. There were about 600 bidders and 1000 targets that were announced in the 10-year period, from 1990 to 1999. However, on checking through the annual reports and announcement files, only about 53 (414/781) per cent of the targets announced were successfully taken over by the bidders.

Controlled companies for the bidders were drawn from the population that match the size of the bidder type of industry and their principal activities (as described in the KLSE Companies Handbook, various years) around the date of announcement. The control companies should not experience any M&A activities during the period of study in order to provide a performance benchmark for the effects of M&A.

Table 3 shows the selection criteria for the targets that were included in this study. Table 4 shows the descriptive statistics of the variables used. PREM, FS, MS and RSIZE

Table 3. Sample selection criteria

	1990s
Announcement	781
Confirmed M&A	
Targets from non-public listed companies	356
Targets from public listed firms	51
Targets from foreign firms	28
Total	435
Purchase price more than RM 20 million	223
Purchase stake more than 33.3% for PLCs	39
Purchase stake of 100% for non-PLCs	231
Purchase stakes of more than 33.3% for PLCs and purchase price more than RM20 million	31
Purchase stakes of 100% and purchase price more than RM20m	125
Total	156
Minus	
Bank, finance and utilities companies	19
Total Targets	137
Total bidders	98
Incomplete information/with confounding events	46
Total available sample for bidders' cash flow analysis	52

Table 4. Descriptive statistics of the variables used

	Minimum	Maximum	Mean	Std. Deviation	Skewness
ACFRPOST	-.266	.583	.002	.141	1.389
DIFF_OWN	.000	1.000	.233	.426	1.291
DIRO	.000	1.000	.373	.487	.537
OS	.000	1.000	.507	.503	-.028
DUM_MS1	.000	1.000	.797	.405	-1.511
LNRA_FS1	-5.947	9.776	-.423	2.843	.944
ACFRPRE	-.399	.220	-.028	.105	-.957
LNRSIZE	-5.120	6.176	.962	1.945	-.156
MPAY	.000	1.000	.274	.449	1.035
LNPREM	-1.056	6.446	1.830	1.763	.399

were not normally distributed and had negative values in the initial computation. PREM was then transformed to its absolute value.² As for MS, dummy values, 0 was assigned to negative value and 1 to positive value. The new variable for MS is DUM_MS1. In order to get normal distributions for the absolute value of PREM, FS and RSIZE, natural log was used to further transform the value. LNPREM, LNRA_FS1 and LNRSIZE replaced variables PREM, FS and RSIZE respectively. By checking through the VIF statistics, the independent variables were found to be free of multicollinearities. Thus, we proceeded with the regression analysis.

4. Results

The results are presented in the following sequence. First, we show how the bidding firms performed (ACFR) compared to their industry counter parts before and after the takeovers. Then we examine whether there is any significant improvement in performance of the bidding firm after takeover. Lastly, we look at the effects of the determining factors on performance changes.

4.1 Control Adjusted Cash Flow Returns (ACFR)

Table 5 shows the ACFR for the pre- and post-takeover. The cash flow returns for the bidders before takeover significantly underperformed the benchmarks at the 5 per cent level of significance. However, after the takeover, there was no difference in the cash flow returns between the bidders and the benchmark firms. This is supported by Table 6 which shows a significant improvement in the ACFR for the bidder after takeover at the 5 per cent level of

¹ If the total liabilities of the targets are higher than the total asset, a negative book value will result. The absolute value for the premium will be minus one from the negative premium computed. For example if the book value is RM-5 and the purchase price is RM20, the ratio of purchase price/book value will be -4; however, due to the negative value, the actual premium is 5 times more than its book value.

Table 5. One sample *t*- test for ACFRPRE and ACFRPOST

Test value = 0			
	<i>t</i>	Sig. (2-tailed)	Mean difference
ACFRPRE	-2.249	.028	-.028
ACFRPOST	.117	.908	.002

Table 6. Paired sample test for ACFRPRE and ACFRPOST

		Paired differences	<i>t</i>	Sig. (2-tailed)
		Mean Std. deviation	Std. error mean	
Pair 1	ACFRPOST - ACFRPRE	.028 .146	.017	1.632 .107

significance (for one-tailed test). Thus, we can infer that on average, takeovers in the 1990s were driven by the bidders' under-performance compared to the benchmark firms of approximately similar size in the same sector. The motivation is at least to be at par with the benchmarks in terms of their operating performance.

The underperformance of the bidders in the sample is mainly due to the changing economic focus in the 1990s. For instance, some of the bidders involved in the mining sector were motivated to diversify their business into non-related industries due to the depletion of mineral resources as well as poor commodity prices in the 1990s. This resulted in many companies in the property industry and finance or investment related industry being taken over during the period. The takeover activities were also facilitated by the economic boom, capital market expansion and ease of credit facilities before the crisis.

4.2 Multiple Regression Results

Table 4.3 shows the results of the regression analysis. In the overall model (model 1), the constant, DIFF_OWN, DIRO, ACFRPRE, and MPAY were found to be significant. The signs of all the coefficients were correct except OS, DUM_MS and LNPREM. However these variables were not significant. Since the proxy for synergies OS, DUM_MS1 and LNRA_FS1 were not significant in Model 1, they were dropped from the subsequent models. The degree of freedom for the models increased from 43 and 44 for model 1 and 2 to 51 for model 3 and 4 (Healy *et al.* 1992, d.f = 44; Abdul Rahman 2004, d.f.=82; Ali and Gupta 1999, d.f. = 44). The dropping of these variables did not change the overall significance of the individual coefficients; instead, the adjusted R square improved from 12 per cent in Model 1 to about 20 per cent in Model 4. The *F*-statistics showed an overall model fit significant at 1 per cent level. The positive sign and significance of the constant (α) indicate that there is a significant improvement in the merged firms' cash flow returns due to the takeovers, independent of other variables.

Table 7. Determinants of post- takeover performance

	Model 1	Model 2	Model 3	Model 4
(Constant)	0.1124*	0.0637**	0.034	0.0398*
DIFF_OWN	-0.1160**	-0.1104**	-0.057*	-0.0595*
DIRO	-0.1045**	-0.0893**	-0.070**	-0.0671**
OS	-0.0015	-0.0052		0.013
DUM_MS1	-0.0487			
LNRA_FS1	0.0077	0.0091		
ACFRPRE	0.3746*	0.4356**	0.496***	0.4992***
LNRSIZE	-0.0084	-0.0047	-0.006	-0.0056
MPAY	-0.0519*	-0.0605*	-0.034	-0.0341
LNPREM	0.0060	0.0099	0.005	0.0055
R	0.5533	0.5621	0.5523	0.5503
R square 0.3061	0.3159	0.305	0.3028	
Adjusted R square	0.1224	0.1639	0.1944	0.2098
Sig. of F-statistic	0.1360	0.0642	0.0182	0.0096
d.f.	43	44	51	51
Dependent variable: ACFRPOST				

* Significantly different from zero at the 10 per cent level, using a one-tailed test.

** Significantly different from zero at the 5 per cent level, using a one-tailed test.

*** Significantly different from zero at the 1 per cent level, using a one-tailed test.

The uniqueness of many Malaysian corporations lies in the fact that they are still very much dependent on the family owners to run the corporations as opposed to the US firms which are run by professional managers. In the sample, 77 per cent of the bidders were controlled by concentrated ownership. Claessens *et al* (1999) contend that the primary issue for large corporations in East Asia is not the conflict of interest between owners and managers, but between the majority and minority shareholders. However, in this study, diffused ownership consistently showed a negative impact on the post-takeover performance. It also showed, on the contrary, concentrated ownership has a positive impact on the post- takeover performance. This supports the argument put by Morck and Yeung (2004) that performance of concentrated ownership firms is better than diffused ownership in developing countries. Chu and Cheah (2004) also posit that concentrated ownership, which is mostly owned by family group, still maintains the passion for entrepreneurship, focuses on firms' output efficiency-expansion and maximisation of shareholders' value. The preference for concentrated ownership is also supported by Jensen and Meckling (1976) who state that an that increase in the level of managerial ownership would lead to alignment of interests between managers and shareholders and thus increase firm value.

The directors or substantial shareholders' equity stakes in the target firms prior to takeover (DIRO) are found to have a negative impact on the post-takeover performance. About one third of the sample exhibited this characteristic. This could be due to what Johnson *et al.* (2000) termed the "tunnelling" effects where the controlling shareholders transfer out resources from the corporation for their own private benefits at the expense of minority

shareholders. More than 50 per cent of the sample showed that the premium paid was more than 3.8 times higher than the book value. This is much higher than those found in the developed countries. It is reported that by using the market model, the premium paid is about 1.16 times to 1.5 times in the US (Jarell *et al.* 1988; Jensen and Ruback 1983; Slusky and Caves 1991; Walkling and Edmister 1985). The studies on bank acquisitions by Shawky *et al.* (1996) and Palia (1993) found that the average premium paid is between 1.79 to 2.24 times more than the book value. Although the relationship between premiums paid and post-takeover performance is positive, however, it does not significantly contribute to the variations in post-takeover performance.

The motives for synergies do not explain the variations in post-takeover performance. Thus, the hypothesis that good managers will vigorously seek for underperforming targets in order to exercise their managerial expertise or disciplinary role and generate managerial synergies is not supported. Likewise, the hypothesis that managers seek to exploit operational synergy by acquiring targets that have overlaps in the activities of the two firms (Sudarsanam *et al.* 1996) also does not apply in this study as well. Although the percentage of companies diversifying into related business has increased compared to the 1980s, there are still many companies (about 50 per cent) pursuing non-related diversification. Generally, takeovers of companies in the 1990s were driven by the underperformance of the bidder compared to their industry counterpart as highlighted in the earlier section. The motive to tap the unused debt capacity in either the target or bidder is also not supported.

The control variable ACFRPRE indicates that the pre-takeover performance tends to persist over time. The RSIZE, although not significant, shows the correct sign. This indicates that if the target size is bigger, the impact of the combination will be more significant. This is due to the potential economies of scale or scope that could benefit the combined firm. This result partially supports the findings of Jarrell and Poulsen (1989) and Loderer and Martin (1992).

The MPAY shows negative effects on post-takeover performance for models 1 and 2. This is consistent with the findings of Chang (1998), Fuller *et al.* (2002) and Abdul Rahman (2002). As the bulk of the sample was privately-held targets and financed by equity, this led to the creation of large blockholders in the combined firms. These blockholders could serve as an effective monitor of managerial performance or facilitate takeovers (Shleifer and Vishny 1986). The willingness of target shareholders to take large positions in a firm also conveys favourable information about the firm.

5. Concluding Remarks

This study explored the possible factors that cause the variations of post-takeover performance by looking into three groups of variables namely ownership structure, takeover motives, and the takeover characteristics as the control variables. We extended the methodology employed by Healy *et al.* (1992), Ghosh (2001), Ali and Gupta (1999) and Abdul Rahman and Limmack (2004) in order to assess the impact of takeovers.

Our findings indicate that large corporate takeovers in Malaysia in the 1990s were driven by underperformance of bidders compared to their matched counterparts. There was a significant improvement in the operating cash flow returns of the combined firms after the takeovers. The post-takeover performance is in contrast to the findings of Mat Nor and

Mohd Zin (1996) and Ali and Moore (1999) who undertook a market based study.

The ownership variable in this study supports the arguments of Chu and Cheah (2004) that concentrated ownership (without cross-holding) is better than the diffused ownership in developing countries such as Malaysia. It also supports the argument of Morck and Young (2004) that a concerted effort to improve a country's institutions is needed before diffused ownership is desirable. However, in a corporate takeover, if the directors or substantial shareholders have equity stakes in the targets, the evidence of negative effect on post-takeover performance implies that "tunnelling" effect might have taken place. As a result of this type of *de facto* expropriation, resources of the bidding firms may be misallocated and directed to unproductive resources instead of increasing efficiency of the bidding firms. Consistent with this argument, the motives for synergies, namely operational, managerial and financial synergies were found to have no significant impact on the post-takeover performance.

References

- Abdul Rahman, R. 2002. Effects of acquisition characteristics on the post-acquisition performance of Malaysian companies. *Asian Review of Accounting* 10(1): 49-76.
- Abdul Rahman, R. and R. J. Limmack. 2004. Corporate acquisition and the operating performance of Malaysian companies. *Journal of Business Finance and Accounting* 31(3/4).
- Agrawal, A., G. F. Jaffe and G. N. Mandelker. 1992. The post-merger performance of acquiring firms: A reexamination of an anomaly. *Journal of Finance* XLVII(4): 1605-1621.
- Ali, R. 1998. *Pengambilan korporat di Malaysia: Sebab dan kesan*. Penang, Malaysia: PhD Thesis, School of Management, Universiti Sains Malaysia.
- Ali, R. and G. Gupta. 1999. Motivation and outcome of Malaysian takeovers: An international perspective. *Vilka: Journal for Decision Makers* 24(3): 41-49.
- Ali, R. and N. H. Moore. 1999. Return to Shareholders of Malaysian Successful Takeover Firms. Paper presented at 11th PACAP/FMA Finance Conference July, Singapore.
- Amihud, Y. and B. Lev. 1981. Risk reduction as a managerial motive for conglomerate mergers. *Bell Journal of Economics*: 605-617.
- Barber, B. M. and J. L. Lyon. 1996. Detecting abnormal operating performance: The empirical and power specification of test statistics. *Journal of Financial Economics* 41: 359-399.
- Berle, A. and G. C. Means. 1932. *Property in Transition*. London: Macmillan.
- Chang, S. 1998. Takeovers of privately held targets, methods of payment and bidder returns. *Journal of Finance* 53(2): 773-784.
- Chang, S. J. 2003. Ownership structure, expropriation, and performance of group-affiliated companies in Korea. *Academy of Management Journal* 46(2): 238-253.
- Chu, E. Y. and K. G. Cheah. 2004. The determinants of ownership structure in Malaysia. *Proceedings of the Malaysian Finance Association 6th Annual Symposium*, 5-6 May. Universiti Utara Malaysia.
- Claessens, S., S. Djankov, J. Fan and L. Lang. 1999. Expropriation of Minority Shareholders in East Asia. World Bank Working Paper, (WPS 2088).
- Davis, G. F., K. A. Diekmann and C. H. Tinsley. 1991. Agents without principles? The spread of the poison pill through the intercorporate network. *Administrative Science Quarterly* 36: 583-613.
- Duhaime, I. M. and C. R. Schwenk. 1985. Conjecture on cognitive simplifications in acquisition and divestment decision making. *Academy of Management Review* 10: 287-295.
- Dun and Bradstreet. 1997. *Key Business Directory of Malaysia*. Singapore: Dun and Bradstreets.
- Franks, J. R. and R. S. Harris. 1989. Shareholder wealth effects of corporate takeover: the U.K. experience. *Journal of Financial Economics* 23(2): 225-249.

- Fuller, K., J. Netter and M. Stegemoller. 2002. What do returns to acquiring firms tell us? Evidence from firms that make many acquisitions. *The Journal of Finance* LVII(4): 1763-1793.
- Ghosh, A. 2001. Does operating performance really improve following corporate acquisitions? *Journal of Corporate Finance* 7: 151-178.
- Healy, P.M., K.G. Palepu and R.S. Ruback. 1992. Does corporate performance improve after mergers. *Journal of Financial Economics* 31: 135-175.
- Jarrell, G. A. and A. B. Poulsen. 1989. The returns to acquiring firms in tender offers: evidence from three decades. *Financial Management*: 12-19.
- Jarrell, G. A., J. A. Brickley and J. M. Netter. 1988. The market for control: the empirical evidence since 1980. *Journal of Economic Perspectives* 2(1): 49-68.
- Jensen, M. C. 1986. Agency costs of free cash flow, corporate finance and takeovers. *American Economic Review* 76(2): 323-329.
- Jensen, M. C. and R. S. Ruback. (1983). The market for corporate control: The scientific evidence. *Journal of Financial Economics*, 11: 5-50.
- Jensen, M. C. and W. H. Meckling. 1976. Theory of the firm: managerial behavior, agency costs and ownership structure. *Journal of Financial Economics* 3: 305-360.
- Johnson, S., Rafael La-Porta, F. Lopez-de-Silanes and A. Shleifer. 2000. Tunneling. *American Economic Review* 90(2): 22-27.
- KLSE. *KLSE Statistics*. (Various issues). Kuala Lumpur: Kuala Lumpur Stock Exchange.
- KLSE. *Annual Companies Handbook*. (Various issues). Kuala Lumpur: Kuala Lumpur Stock Exchange.
- KLSE. *Investors Digest*. (Various issues). Kuala Lumpur: Kuala Lumpur Stock Exchange.
- La-Porta, R., F. Lopez-De-Silanes and A. Shleifer. 1999. Corporate ownership around the world. *Journal of Finance* LIV(2): 471-517.
- La-Porta, R., F. Lopez-de-Silanes, A. Shleifer and R. W. Vishny. 1998. Agency Problems and Dividend Policies around the World. NBER Working Paper 6594.
- Lemmon, M. L., and K. V. Lins. 2003. Ownership structure, corporate governance and firm value: evidence from the East Asian financial crisis. *Journal of Finance* (forthcoming).
- Loderer, C. and K. Martin. 1992. Post-acquisition performance of acquiring firms. *Financial Management*(Autumn): 69-79.
- Loh, S. C. 1996. Corporate Powers: Controls, Remedies and Decision Making. Kuala Lumpur: Malayan Law Journal Sdn Bhd.
- Loughan, T. and A. M. Vijh. 1997. Do long term shareholders benefit from corporate acquisitions? *Journal of Finance* LII(5): 1765-1790.
- Marris, R. 1964. *The Economic Theory of Managerial Capitalism*. New York: Free Press of Glencoe.
- Mat Nor, F and Abdul R. Mohd Zin. 1996. *Malaysian Mergers and Acquisitions: Theory and Selected Cases*. Petaling Jaya, Malaysia: U-Text.
- McConnell, J. J. and H. Servaes. 1990. Additional evidence on equity ownership and corporate value. *Journal of Financial Economics* 27(2): 595-612.
- Meggison, W. L., A. Morgan and L. Nail. 2004. The determinants of positive long-term performance in strategic mergers: Corporate focus and cash. *Journal of Banking and Finance* 28: 523-552.
- Moeller, S. B., F. P. Schlingemann and R. M. Stulz. 2004. Firm size and the gains from acquisition. *Journal of Financial Economics* 73(2): 201-229.
- Morck, R., A. Shleifer and R. Vishny. 1988. Management ownership and corporate performance: an empirical analysis. *Journal of Financial Economics* 20: 293-315.
- Morck, R., and Yeung, B. 2004. Corporate Governance and Family Control. World Bank Policy Research Working Paper: Special Issues Related to Corporate Governance and Family Control, (WPS 3406)
- Mueller, D. C. 1969. A theory of conglomerate mergers. *Quarterly Journal of Economics* 83: 643-659.
- Mueller, D. C. 1986. *Profits in the Long Run*. Cambridge: Cambridge University Press.

- Mueller, D. C. 1995. Mergers: Theory and Evidence. In *Mergers, Market, and Public Policy*, ed. G. Mussati, pp. 9-43. Dordrecht, The Netherlands: Kluwer academic.
- Myers, S. C. and N. S. Majluf. 1984. Corporate financing and investment decisions when firms have information that investors do not have. *Journal of Financial Economics* 13: 187-221.
- Palia, D. 1993. The managerial, regulatory, and financial determinants of bank merger premiums. *Journal of Industrial Economics* XLI(1): 91-101.
- Powell, R. G. and A. W. Stark. 2005. Does operating performance increase post-takeover for UK takeovers? A comparison of performance measures and benchmarks. *Journal of Corporate Finance* 11: 293-317.
- Ravenscraft, D. J. and F. M. Scherer. 1989. The profitability of mergers. *International Journal of Industrial Organization* 7: 101-116.
- Roll, R. 1986. The Hubris hypothesis of corporate takeovers. *Journal of Business* 59(2): 197-216.
- Securities Commission of Malaysia (SCM). 1998. Code of Takeover and Mergers. Kuala Lumpur: Securities Commission.
- Securities Commission of Malaysia (SCM). *Annual Report* (Various issues). Kuala Lumpur: Securities Commission.
- Seth, A. 1990. Value creation in acquisitions: a re-examination of performance issues. *Strategic Management Journal* 11: 99-115.
- Shawky, H. A., T. Kilb and C. F. Staas. 1996. Determinants of bank merger premiums. *Journal of Economics and Finance* 20(1): 117-131.
- Shleifer, A. and R. W. Vishny. 1986. Large shareholders and corporate control. *Journal of Political Economy* 94(3): 461-489.
- Shleifer, A. and R. W. Vishny. 1990. The new theory of the firm: equilibrium short horizons of investors and firms. *American Economic Review, Papers and Proceedings* 80(2): 148-153.
- Sirower, M. 1997. *The Synergy Trap*. New York: The Free Press.
- Slusky, A. R. and R. E. Caves. 1991. Synergy, agency, and the determinants of premia paid in mergers. *The Journal of Industrial Economics* XXXIX(March): 277-296.
- Sudarsanam, S., P. Holl and A. Salami. 1996. Shareholders wealth gains in mergers: Effect of synergy and ownership structure. *Journal of Business Finance and Accounting* 23(5/6): 673-698.
- Switzer, J. A. 1996. Evidence on real gains in corporate acquisition. *Journal of Economics and Business* 48: 443-460.
- Trautwein, F. 1990. Merger motives and merger prescriptions. *Strategic Management Journal* 11: 283-295.
- Walkling, R. A. and R. O. Edmister. 1985. Determinants of tender offer premiums. *Financial Analysts Journal* Jan/Feb: 27-37.
- Williamson, O. E. 1964. *The Economics of Discretionary Behavior*. Englewood Cliffs, NJ: Prentice Hall.

Research in Malaysia has primarily focused on the after-market and long-run stock price behavior of IPOs (Paudyal *et al.* 1998; Wu 1993; Yong 1991). Relatively less attention has been paid to the long-run operating performance of IPO firms. In this study, we do not look at price performance of Malaysian IPOs, but rather we will investigate the operating performance of firms pre- and post-IPO. In addition, we will also examine whether post-IPO operating performance is determined by some of the pre-IPO factors, namely age of firm, size of firm, dilution of ownership, multi-nationality of firm, and pre-IPO profitability.

Corresponding Author: Zamri Ahmad, School of Management, Universiti Sains Malaysia, 11800 Penang, Malaysia
Email: zahmad@usm.my