China's Cross-border Mergers and Acquisitions:

SOE vs. Non-SOE

by

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I. Abstract

With the recent surge of China's cross-border M&A, this paper examines different performance of SOE acquirers and non-SOE acquirers. Although SOEs still dominate the market in terms of capital value, the rise of non-SOEs is undeniable and they are taking larger and larger share of overseas M&A flows. By measuring CAR and Tobin's Q of individual acquirers for 561 China's cross-border M&A deals from January 1st, 2010 to October 31st, 2016, this paper compared SOE acquirers and non-SOE acquirers' performance both in the short run and in the long run. Results show SOE acquirers tend to have higher CAR than non-SOE acquirers in the short run but non-SOE acquirers tend to have higher Tobin's Q ratio than SOE acquirers in the long run. Taking sustainability into consideration, non-SOE acquirers are better at choosing M&A targets and integrating cross-border M&A deals.

Keywords: cross-border, mergers and acquisitions, SOE, CAR, Tobin's Q

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III. Introduction

What is eye-catching in today's business news page around the world is the frequent cross-border mergers and acquisitions announced by Chinese firms. According to *The Wall Street Journal,* Chinese companies had completed a record of $110.8 billion overseas M&A deals by the end of May 10th in 2016. It had surpassed the full record of $106.8 billion in 2015. Statistics released by *Dealogic* showed that up to May 25th during 2016, the amount of global cross-border transactions had reached $1.292 trillion and China's market share has doubled to 24.3% compared with 2015. In February 2016, the China National Chemical Corp. offered a $43 billion deal for Syngenta AG, a Swiss agrochemicals and seeds producer, marking another milestone for China's M&A business overseas. However, it is still controversial and uncertain whether the fast growing overseas M&A creates value for Chinese firms. For instance, in 2014 Chinese property giant Wanda acquired the Edificio Espana building in Spain for €265 million aiming to renovate it into a luxury hotel and a shopping centre for Chinese tourists traveling to Spain. Nevertheless, Wanda is now on track of selling the building for €272 million due to conflicts with the local authorities, resulting in a potential exit from Spanish Market.

Encouraged by governmental policies such as "Going Global" and "One Belt, One Road", more and more Chinese firms realized the opportunities for international business. Cross-border M&A is one of the primary mode for Chinese companies to enter foreign market. With eased restrictions on overseas purchases, outbound M&A deals under $1 billion made by SOEs no longer required regulatory approvals. What is more, the number of privately owned enterprises in outbound M&A also largely increased in recent years. Although SOEs still dominate the market in terms of capital value, the rise of non-SOEs is undeniable and they are taking larger and larger shares of overseas M&A flows. Therefore, it is important to consider that

the structure of Chinese cross-border M&A participants is changing and understanding the return carried by these two groups is essential for making policies that cater to different characteristics of these two groups.

The paper proceeds as follows: Section IV gives a brief literature review on the performance of SOEs and non-SOEs cross China's cross-border M&A history and introduces our hypotheses. Section V outlines the data and methodology. Section VI presents statistical results and our explanations. Section VII discusses potential implications derived from this paper.

IV. Literature Review and Hypotheses

Literatures in M&A field produced variant results and conclusions on topic of value creation. Du and Boateng (2014) find out that Chinese bidders in cross-border M&A business experience wealth gains ranging from 0.4771% to 1.5210% over a 10-day event window. Zhou *et al.* (2012) suggest that SOE acquirers outperform POE acquirers in terms of long-run stock performance and operating performance in domestic M&A. They argue that the gains from government intervention outweigh the inefficiency of state ownership in Chinese mergers and acquisitions. However, no previous literature compares the performance of SOE and non-SOE in cross-border M&A settings. With the recent surge of China's cross-border M&A, this paper presents another perspective in this field.

In response to "Going Global" and "One Belt, One Road" policy, Chinese government encourages firms to invest abroad by providing favorable governmental and financial supports. According to Luo, Xue, and Han (2010), the government provides incentives ranging from tax deductions, low-interest loans to inter-governmental investment treaties so as to reduce financial concerns for companies who intend to purchase overseas. In addition, state-owned companies are particularly aware of policy advantages and are in general enjoy better supports. Investors in

China are aware of the power of governmental supports and its importance in cross-border M&As. Therefore, we expect that

H1: in the short run, SOE acquirers will have better returns than Non-SOEs acquirers due to favorable policy and financial supports.

However, the internal bureaucratic characteristics of Chinese SOE may result in losses in value creation in the long run. While non-SOE are more careful in choosing acquisition targets, they tend to maximize shareholder value and leverage operating performance through cross-border M&As. Chinese stock market is not efficient, thus the market might only reflect fair value of stock in the long run. Therefore, we expect that

H2: In the long run, Non-SOE acquirers will perform better than SOE acquirers due to SOE's inherent bureaucracy characteristics.

We use cumulative abnormal return (CAR) as a proxy for companies' short run performance and we use Tobin's Q ratio as a proxy for companies' long run performance. Other than the ownership of companies, there are other factors affecting company performance. In this paper, we also include factors such as deal size, payment method, bidder size, target public status, bidder's ROE, and bidder's six-month return.

For both SOEs and non-SOEs, we expect larger deal size will produce less value for the acquirers because large deals are more complicated to integrate and require more efficient and competent managerial team. Besides, large deal size is more likely to be intervened and restrained by government in order to prevent monopoly or protect local firms.

For both SOEs and non-SOEs, we expect cash-financed acquisition have a positive influence on bidder's performance while equity-financed acquisition has a negative influence on bidder's performance, because using equity as payment method sends a negative signal to the

market that the firm is less liquid, poorly operated and may have some internal problems by Wang, Xie (2009). The market thinks the bidder's ability to generate free cash flow is lower and expects it is less likely for the firm to generate value for its shareholders in long run.

In terms of bidder size, we expect that it will be negatively related to bidder's performance. According to Moeller, Schlingemann, and Stulz (2004), the incentives of managers in small firms are better aligned with those of shareholders than is the case in large firms and managers in large firm are more prone to hubris because their firms have more resources.

For both SOEs and non-SOEs, we expect bidder will perform poorer when the target is public but better when the target is private. This is due to the fact that when public firm acquires public firm, both the bidder's and the target's shareholder value need to be considered; when public firm acquires private firm, the true value of the target is more important and the price offered is better negotiated. Thus the market tends to think the deal that involves a private target is undervalued.

In terms of previous financial performance, we expect bidder's ROE to be positively related to its performance. Higher ROE shows better profitability of bidder prior to M&A deal and pre-acquisition performance of the acquiring firm is positively related to its acquisition performance according to Wu, Xie (2010).

Similar relationship is expected to be found between bidder's six-month return and its performance. Higher stock return shows better profitability of bidder prior to M&A deal and pre-acquisition performance of the acquiring firm.

V. Data and Methodology

Data of this study contains 561 Chinese cross-border M&A attempts announced by Chinese companies between January 1st, 2010 and October 31st, 2016. 133 attempts are made by

SOE acquirers and 428 attempts are made by non-SOE acquirers. Information related to deal characteristics is retrieved from Bloomberg database. Information related to company characteristics and acquirers' financial statements such as legal status of acquirers and stock price of acquirers are retrieved from Wind database, which specializes in Chinese financial information services. All acquirers in this study are listed companies on either Shanghai Stock Exchange or Shenzheng Stock Exchange.

To examine short term performance, the regression is

$$\begin{aligned} CAR_s = {} & c_1 + \alpha_1 SOE\ Acquirer\ Dummy + \alpha_2 Log(Deal\ Size) \\ & + \alpha_3 Log(Deal\ Size) * Cash\ Dummy + \alpha_4 Log(Bidder's\ Size) \\ & + \alpha_5 Target\ Status\ Dummy + \alpha_6 Bidder's\ ROE \\ & + \alpha_7 Bidder's\ Six\ Month\ Return \end{aligned}$$

where the independent variable for short run is CAR. The dependent variables are i) SOE dummy variable to represent whether the acquirer is owned by central or local government; ii) the natural logarithm of deal size and iii) its result multiplies a cash dummy variable to see if cash financing has an effect; iv) the natural logarithm of bidder size; v) target status dummy variable with public status equals to one; vi) bidder's ROE from previous fiscal year; vii) bidder's latest six-month stock return.

To calculate CAR, we adopt an event window of (-1,1). CARs are calculated as

$$CAR_{it} = \sum_{t-1}^{t+1} (R_{i,t} - E(R_{i,t}))$$

where $R_{i,t}$ is individual firm *i*'s return on day *t* and $E(R_{i,t})$ is the expected stock return of firm *i* on day *t*. The expected stock return is calculated using CAPM.

Following Chung and Pruitt (1994), we use a method of Approximate Q to assess the long-term performance of companies at least one year after the announcement of mergers and acquisitions. The formula adopted is

$$Approximate\ Q = \frac{(MVE + PS + DEBT)}{TA}$$

where *Approximate Q* is an estimation of Tobin's Q based on company's financial statements, *MVE* is the market value of company's outstanding equity, *PS* is the liquidating value of preferred stock, *DEBT* is the current liabilities net of current assets, plus the book value of long-term debt, *TA* is the book value of total assets. All the data is retrieved from Wind database. We tried to measure firm performance for at least one year after deal announcement. For instance, if the deal was announced in year 2012, we calculated Tobin's Q by using financial statements of the firm at the end of fiscal year 2013. For deals announced in 2016 before October, we used financial statements disclosed in the third quarter of 2016. For deals announced in 2016 October, we eliminated those deals because firms have not yet finished disclosing their financial statements.

To examine whether SOE acquirers perform differently from non-SOE acquirer in the long run, the second regression is

$$\begin{aligned} Tobin's\ Q_s\ = c_2 &+ \beta_1 SOE\ Acquirer\ Dummy + \beta_2 Log(Deal\ Size) \\ &+ \beta_3 Log(Deal\ Size) * Cash\ Dummy + \beta_4 Log(Bidder's\ Size) \\ &+ \beta_5 Target\ Status\ Dummy + \beta_6 Bidder's\ ROE \\ &+ \beta_7 Bidder's\ Six\ Month\ Return \end{aligned}$$

It adopts Tobin's Q as a new dependent variable and keep other independent variables same as the first regression. **Table 1** and **Table 2** show descriptive statistics and Pearson Correlations for all variables.

For our research, Regression (1) includes all cross-border deals, regression (2) adds two independent variables which are SOE*6-month return and SOE*Bidder's Size, regression (3) adds one more independent variable, which is a Cash dummy. We also examine non-SOE acquirers and SOE acquirers separately.

In order to examine whether China's M&A market perform differently across time periods, we split the samples into two subsets based on time order. First 281 deals and later 280 deals are grouped respectively for further regression analysis. Details are shown in **Table 4**.

VI. Results and Findings

The multivariate regression results presented in **Table 3** suggest that SOE acquirers and non-SOE acquirers have performed differently in stock return around their announcement date of cross-border deals. For an event window of (-1,1) in the first regression, the coefficient of SOE dummy variable is positive and is statistically significant at 5% level. It shows that given other conditions constant, being SOE acquirers tend to have 2.6% higher CAR than non-SOE acquirers. It is possible that investors may respond greater when non-SOE acquirers announced their M&A plans. The better performance of SOE acquirers in short run is consistent with Hypothesis 1. Our explanations here contain four aspects. First, a lot of SOE M&A deals involve national strategies and are influenced by the government to achieve political and economic goals. Therefore, SOE acquirers may have better governmental support to help them acquire target firms in industries under tight government control, such as resource-related bidding. Second, SOE acquirers enjoy favorable financial supports, such as privileged bank loans, government subsidies, less restricted foreign exchange control. These supports provide SOE acquirers with stronger purchasing power, making it possible for them to put forward with competitive offerings when bidding abroad. In addition to that, media presence may also draw stock returns for SOE

acquirers. In general, SOE outbound M&A deals contain greater value and even involve direction of national development while deals announced by non-SOE acquirers are smaller in deal size and are less significant in terms of national strategies. Therefore, deals announced by SOE acquirers might receive more media attention and are more likely to get publicity. Finally, investors have higher confidence in completion rate for SOE acquirers thanks to previous reasons. Higher possibility of completing the deals might attracts short term investment for the companies. It is possible that SOE acquirers achieve higher CARs in the short run.

Another interesting finding is the relationship between companies financial and stock performance prior to the announcement date and their CARs around announcement date. As is showed in **Table 3**, companies who have higher ROE from previous fiscal year receive lower CARs around the announcement date. The coefficient is statistically significant at 1% level. Same result happens to six-month return variable. Companies who have higher stock return over six months prior to the announcement date tend to receive lower CARs. The coefficient is also statistically significant at 1% level and is particularly significant for non-SOE acquirers. Possible explanations are as follow. First, companies who had lower ROE before tend to improve their performance by doing M&As. M&A is an important way to generate growth and expand production. McCardle and Viswanathan (1994) and Jovanovic and Braguinsky (2002) argue that companies make mergers and acquisitions when they cannot create growth opportunities inside the company. Investors expect companies who performed not well before will perform better after they choose to merge or acquire. Second, companies who have higher ROE and returns tend to purchase a firm in different industry. For instance, in the dataset, Zhejiang Sanhua, a metal processer firm, tried to purchase HelioFocus Ltd, an Israeli energy firm in 2011. Zhejiang Sanhua had a six-month return of 32.2% before M&A but had a -3.87% stock return around

announcement date. Investors may not be confident in such cross-border M&As, especially when most of these cross-industrial M&As were conducted by non-SOEs. Therefore, in the short run, market reacts differently to SOE deals and non-SOE deals and investing behavior is largely based on the ownership of the acquirers.

In terms of different time periods, we see from the **Table 4** that deals acquirers obtain higher CARs in recent 280 cases. Intercepts from each regression is higher for later 280 cases than the first 281 cases, and intercepts are higher for non-SOEs, indicating in recent time period, cross-border M&As create higher short-term stock value for domestic acquirers, especially non-SOE acquirers. Seen from the regressions for total sample, the effect of being SOE is also stronger for more recent time period, although it does not show statistical significance for the later period.

For companies' long-term performance, multivariate regression results are presented in **Table 5**. The independent variable is Tobin's Q, which is calculated through the method of approximate Q. Sample size is slightly smaller because some deals are announced in October 2016 but the acquirers have not released their latest financial statements yet at the beginning of 2017. From the results, SOE acquirers have poorer post-merger performance than non-SOE acquirers by having lower Tobin's Q ratios. With a firm being SOE, its Tobin's Q after M&A announcement is 1.022 lower than non-SOE and the result is statistically significant at 1% level. This result is opposite to the short term performance but is consistent with Hypothesis 2. Chinese stock markets in Shanghai and Shenzhen are collectively inefficient. Thus, in the short term stock price cannot timely and accurately reflect firm value. In the long run, after digesting market information, market value of firms better reflects company performance after their announcement of mergers and acquisitions. Several reasons could contribute to the result that

SOE acquirers perform poorer than non-SOE acquirers. First, as was argued by Xu, Zhu and Lin (2005), the performance of SOEs suffers from both political costs and agency costs. Managers are sometimes nominated by government in SOEs. Instead of seeking purely for economic growth, firms controlled by politicians also take political goals into consideration. Politicians may have incentives to subsidize SOEs or carry out projects that are not economically efficient to serve political purposes. In another word, maximizing shareholder profits is not a priority for managers in SOEs. Thus, non-SOE are more likely to choose a better target in cross-border M&A. Another reason may be the size effect. According to Moeller, Schlingemann, and Stulz (2004), the incentives of managers in small firms are better aligned with those of shareholders than is the case in large firms and managers in large firm are more prone to hubris because their firms have more resources. This applies to SOEs since most of them are gigantic in firm size and bureaucratic characteristics may lead to inconsiderate M&A decisions. Third, many previous literatures show larger firms pay higher premium in M&As. Recent paper (Guo, Clougherty and Duso, 2011) suggests Chinese state-owned MNEs pay higher M&A premiums than do non-state-owned MNEs. SOEs have favorable funding policies from government and tend to pay more due to a lack of efficient monitoring. The higher price a company bid, the lower return a company can expect. Therefore, in the long run, M&As may create more value for non-SOEs than that for SOEs.

In the long run, previous return such as ROE and six-month return performance are consistent with the Tobin's Q ratios. Coefficient for bidder's ROE from previous fiscal year is positive and is statistically significant at 10% level. Coefficient for bidder's six-month stock return prior to announcement date is positive and is statistically significant at 1% level. Higher ROE and six-month return bring better post-merger performance because of consistent firm

performance. Companies who performed well previously tend to perform well in later period as well. Companies who manage well previously tend to integrate M&A deals better after a period of time.

VII. Conclusions and Implications

Findings of this paper indicates that although SOE acquirers enjoy governmental and financial supports, cross-border M&A may still not be beneficial to them if they do not carefully choose targets and establish individual accountability for post-merger performance. In order to raise efficiency for SOEs, firms need to simplify bureaucratic process and reduce layers of officials that are required to report to before making acquisition decisions. From the opposite results of stock market performance between short run and long run, Chinese stock market need to improve information transparency so as to improve market efficiency. Therefore, further improve short-term stock return performance to better reflect the value that cross-border M&A might brought to firms in the long run. Given the increased number and size of non-SOE acquirers in cross-border M&A business, government need to improve policy supports. Not only providing favorable policies for non-SOE to going global but also improve services to make sure non-SOE are aware of policy supports and are indeed benefited from these policies. Since non-SOE acquirers make more considerate M&A decisions and are better incentivized to incorporate cross-border M&A deals, governmental policies can encourage non-SOE acquirers to seek for good targets in new industry such as media, hotel, entertainment, sports areas. This not only encourages companies to go out, but also utilizes individual enterprise's motivation to expand new industries in China.

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IX. Appendix

Table 1. Descriptive Statistics and Pearson Correlation (CAR)

	Mean	S.D.	CAR (-1,1)	SOE=1	Log (Deal Size)	Log (Deal Size)*Cash	Log (Bidder's Size)	Target Status (Public=1)	Bidder's ROE (Latest FS Before Announcement)	6-month return
CAR (-1,1)	1.44%	10.91%	1							
SOE=1	0.24	0.43	0.074	1						
Log(Deal Size)	17.0083	1.9658	0.000	0.234**	1					
Log(Deal Size)*Cash	16.10	4.084	0.022	0.015	0.256**	1				
Log(Bidder's Size)	23.36	1.246	-0.147**	0.343**	0.343**	0.054	1			
Target Status (Public=1)	0.89	0.31	0.043	-0.065	-0.131**	-0.087*	-0.035	1		
Bidder's ROE (Latest FS Before Announcement)	11.72%	11.70%	-0.162**	-0.090*	-0.041	-0.007	0.339*	0.026	1	
6-month return	20.36%	60.07%	-0.169**	-0.085*	-0.110**	-0.034	0.068	0.036	0.023	1

Notes: N=561, *p<0.05, **p<0.01

Table 2. Descriptive Statistics and Pearson Correlation (Tobin's Q)

	Mean	S.D.	Tobin's Q	SOE=1	Log (Deal Size)	Log (Deal Size)*Cash	Log (Bidder's Size)	Target Status (Public=1)	Bidder's ROE (Latest FS Before Announcement)	6-month return
Tobin's Q	1.99	1.73	1							
SOE=1	0.24	0.43	-0.347**	1						
Log(Deal Size)	17.00	1.96	-0.220**	0.238**	1					
Log(Deal Size)*Cash	16.13	4.05	-0.094*	0.012	0.280**	1				
Log(Bidder's Size)	23.36	1.25	-0.231**	0.347**	0.339**	0.064	1			
Target Status (Public=1)	0.89	0.31	0.107*	-0.063	-0.133**	-0.086*	-0.036	1		
Bidder's ROE (Latest FS Before Announcement)	11.82%	11.68%	0.063	-0.095*	-0.037	-0.018	0.346**	0.029	1	
6-month return	20.43%	60.33%	0.172**	-0.086*	-0.110**	-0.033	0.068	0.036	0.023	1

Notes: N=561, *p<0.05, **p<0.01

Table 3. Acquirers' CAR Regressions

	Total (1)	*Total (2)*	*Total (3)*	*Non-SOEs*	*SOEs*
Intercept	0.273***	0.388***	0.772***	0.383***	0.180*
SOE	0.026**	-0.186	-0.187		
SOE*6-month return		0.041**	0.042**		
SOE*Bidder's Size		0.009	0.009		
Cash			-0.401*		
Log(Deal Size)	0.0001	0.001	-0.0196*	-0.0011	0.0050
Log(Deal Size)*Cash	0.0007	0.005	0.0216*	0.0008	0.0002
Log(Bidder's Size)	-0.012***	-0.017***	-0.017***	-0.016**	-0.009**
Target Status (Public=1)	0.019	0.020	0.020	0.031	-0.004
Bidder's ROE (Latest FS Before Announcement)	-0.097***	-0.088**	-0.0898**	-0.087*	-0.133*
6-month return	-0.027***	-0.036***	-0.037***	-0.036***	0.009
Adj. R^2 (%)	6.08	6.93	7.33	6.88	6.20
N	561	561	561	428	133

***, **, * represent significant level at 1%, 5%, 10%, respectively.

Table 4. Acquirers' CAR regressions with different time periods

	First 281 Cases				*Later 280 Cases*			
	Total (1)	*Total (2)*	*Non-SOE*	*SOE*	*Total (3)*	*Total (4)*	*Non-SOE*	*SOE*
Intercept	0.224**	0.321**	0.371**	0.064	0.378*	0.537**	0.518**	0.299
SOE	0.022*	-0.002			0.033	-0.204		
SOE*6-month return		0.007				0.055**		
SOE*Bidder's Size		-0.140				0.009		
Log(Deal Size)	0.0005	0.0004	-0.0002	0.0035	-0.0002	0.0009	-0.0010	0.0083*
Log(Deal Size)*Cash	0.0005	0.0005	-0.0006	0.0020	0.0007	0.0003	0.0011	-0.0005
Log(Bidder's Size)	-0.009*	-0.014*	-0.014*	-0.005	-0.017*	-0.024**	-0.023*	-0.015*
Target Status (Public=1)	0.002	0.003	-0.004	0.022	0.037	0.037	0.058**	-0.062*
Bidder's ROE (Latest FS Before Announcement)	-0.099	-0.089	-0.065	-0.195	-0.090	-0.076	-0.080	-0.050
6-month return	0.002	0.003	0.004	-0.0007	-0.033***	-0.045***	-0.046***	0.014
Adj. R^2 (%)	2.29	1.82	0.93	3.57	7.00	8.45	9.45	11.71
N	281	281	200	81	280	280	228	52

***, **, * represent significant level at 1%, 5%, 10%, respectively.

Table 5. Acquirers' Tobin's Q Regressions

	Total	*Total (2)*	*Total (3)*	*Non-SOEs*	*SOEs*
Intercept	8.067***	6.292***	0.991	6.955***	7.986***
SOE	-1.022***	-7.453**	-7.439**		
SOE*6-month return		-0.149	-0.181		
SOE*Bidder's Size		0.266*	0.265		
Cash			5.483		
Log(Deal Size)	-0.058	-0.053	0.241	-0.0743	-0.0349
Log(Deal Size)*Cash	-0.022	-0.013	-0.315	-0.0196	-0.0216
Log(Bidder's Size)	-0.216***	-0.150	-0.151	-0.162	-0.260***
Target Status (Public=1)	0.363	0.443**	0.433**	0.466	0.111
Bidder's ROE (Latest FS Before Announcement)	1.251*	0.759	0.755	1.220	0.560
6-month return	0.425***	0.441***	0.455***	0.434***	0.403***
Adj. R^2 (%)	16.96	14.76	14.93	3.94	23.13
N	555	555	555	422	133

***, **, * represent significant level at 1%, 5%, 10%, respectively.