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International investors' reactions to cross-border acquisitions by emerging market multinationals

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Abstract

How do international investors react to announcements of cross-border mergers and acquisitions (CM&As) by emerging market multinational enterprises (EMNEs)? Using a unique and manually-constructed firm-level dataset, this paper examines the stock price reactions to CM&A announcements made over the period 1991 - 2010 by Chinese MNEs listed on the Hong Kong Stock Exchange and the wealth impacts of their corporate governance. Our empirical findings confirm a positive stock price reaction on average, and suggest that international investors react positively to the presence of large shareholders, but negatively to the presence of institutional shareholders. There is a negative impact if the largest shareholder is either the State or the corporate founder. We suggest that this is because the international investors perceive potential principal - principal conflicts in such ownership/control constellations and discount equity prices accordingly. We also find that Board size and independence have positive effects on the price reaction, but that large supervisory boards engender negative reactions.

Keywords: China; Corporate governance; Cross-border mergers and acquisitions Emerging economies; FDI; Multinational enterprises

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1. Introduction

The last decade has witnessed a remarkable surge of outward foreign direct investment (OFDI) from developing economies. Whilst FDI outflows from developed countries declined during and after the global financial crisis of 2007–2008, the developing economies' share of the world's FDI flows continued to rise, surging from 13.5% in 2007 to 24.8% by 2011 (UNCTAD, 2011). One of the primary internationalisation modes for developing country firms has been cross-border mergers and acquisitions (CM&As) (Bhagat, Malhotra, & Zhu, 2011). The share of the world's CM&As made by firms from developing countries nearly doubled from 15% in 2005 to 29% in 2010 (UNCTAD, 2011). In particular, CM&As are the dominant internationalization mode for Chinese firms (Sun, Peng, Ren, & Yan, 2012).

There is a considerable literature investigating the impact of foreign acquisitions by listed companies upon shareholder wealth, and the determinants of the size of that impact. Most of these empirical studies use data for multinational enterprises (MNEs) from the United States or other developed economies, and there are few that focus on multinationals from developing and/or emerging economies (EMNEs). But there are good reasons to suspect that the impact determinants will differ for EMNEs, both because of their different ownership and/or control characteristics and because of the weaker corporate governance and investor protection regimes in their home countries. CM&As are critical strategic decisions that are made by executives (agents) under the supervision of Boards of Directors on behalf of the shareholders (principles). In emerging market economies, formal institutions and external governance mechanisms to protect property rights are often weak or absent, so shareholder concentration is common in order to reduce agent discretion and principal–agent (PA) conflicts (Claessens, Djankov, Fan, & Lang, 2002). However, such shareholding concentrations may also give rise to principal–principal (PP) conflicts whereby controlling shareholders are minded to expropriate the interests of minority shareholders (Claessens, Djankov, & Lang, 2000; Dharwadkar, George, & Brandes, 2000).

EMNEs can take action to offset the weakness of their governance systems at home by internationalising, such as via cross-listing in developed countries to ‘‘bond’’ to better legal and regulatory regimes (Coffee, 1999; Doidge, Karolyi, & Stulz, 2004; Reese & Weisbach, 2002; Stulz, 1999). Indeed, it has been suggested that EMNEs incorporated or cross-listed in developed countries should have a lower risk of information asymmetry and a higher firm value than their domestic counterparts (Lang, Lins, & Miller, 2003; Sami & Zhou, 2008). In this paper, we investigate the shareholder wealth effects in a sample of 335 acquisitions made by Chinese MNEs over the period 1991–2010. A novelty is that we limit our sample to Chinese MNEs that are listed on the Hong Kong Stock Exchange (HKSE). The HKSE adopts international rules for financial reporting, and these are much stricter than in China. The HKSE-listed companies are thus committed to higher disclosure standards than in the domestic Chinese market. Furthermore, domestic Chinese investors are restricted from trading H-shares or investing in Chinese firms incorporate in Hong Kong, hence we will be assessing the reaction of international investors to the CM&A announcements. Such international investors may be assumed to have many potential investment opportunities, and moreover to have the means and expertise to make relatively balanced judgments of the merits of individual CM&A deals. We hypothesise that several dimensions of ownership structure and corporate control, and various internal control mechanisms, should have an impact upon the stock market reactions by international investors to announcements of CM&As.

The paper is structured as follows. We first develop our hypotheses in the light of recent theoretical and empirical work on CM&As. In the following section, we provide a detailed description of the dataset and outline the event study methodology to be used to assess the stock market reactions to the CM&A announcements. We then report our research results first on shareholder value creation and secondly on the relationships between shareholder returns and corporate governance. The last section concludes the paper.

2. Literature review and hypothesis development

2.1. The stock market reaction to announcements of cross-border acquisitions

Both internalisation theory and the resource-based view suggest that firms undertaking FDI must possess some ownership (firm-specific) advantages that not only permit them to be competitive in their home markets, but also allows them to offset the additional costs associated with operating in an overseas market (Zaheer, 1995). The markets for such intermediate products (semi-processed materials, together with various types of knowledge and expertise embodied in human capital and other intangible assets) are typically imperfect, so that FDI is preferred to arm's length contractual arrangements (e.g. licensing) (Buckley & Strange, 2010). Furthermore, FDI may also allow firms to diversify risks and stabilise earnings, because market returns in different geographical areas often show low correlation. It follows that firms will undertake FDI if future synergistic benefits are envisaged and, to the extent that this judgment is shared by investors and markets are efficient (in that prices reflect all available information), the share price of the investing firm should rise on the announcement of the FDI project to reflect this expectation – there will be 'value creation'. This rise in the share price should be evident whether the FDI takes the form of a greenfield venture or the (full or partial) acquisition of a target firm in the overseas host economy. When the FDI takes the form of an acquisition, it is reasonable to assume that the investing firm will transfer some knowledge and expertise to or from the target firm – unless the investment is made purely and simply for the purposes of a financial return–and that some of the potential gain from the FDI project will be reflected in a premium paid for the shares of the acquiring firm (Meyer, Estrin, Bhaumik, & Peng, 2009). If the acquirers are listed, then its share price should thus rise on the announcement of the FDI project as information about the acquisition is made public. This stock market reaction can be assessed either as the abnormal return (AR) on the day of the announcement, or as a cumulative abnormal return (CAR) over an 'event window' around the day of the announcement[1].

[1] See Section 3 for further explanation.

Now the stock markets may have a more sceptical view of the potential synergies from the foreign acquisition[2], and may not have confidence in the firm's strategy, the timing of the FDI project, or the management's ability to implement the project successfully (Woolridge & Snow, 1990; Shimizu, Hitt, Vaidyanath, & Pisano, 2004). It is well-known that many acquisitions, both domestic and cross-border, do not realise the expected synergies either because the integration process proves more difficult or more protracted than expected, or because there were surplus assets and capabilities (including labour) than were costly to release (Shimizu et al., 2004). Moreover, investors may question whether the managers of the acquirer firm make rational and objective decisions based upon the risks and potential gains from the FDI project, whether they overpay for target firms because of hubris, or mould firm strategy to their own objectives (Seth, Song, & Pettit, 2000). Such scepticism will be reflected in a reduced (possibly even negative) share price reaction for the acquiring firm, the target firm, or both.

There is a considerable empirical literature focusing on the short- run stock reactions of acquirer firms to announcements of cross- border acquisitions[3]: see, for example, (Doukas & Travlos, 1988; Conn & Connell, 1990; Morck & Yeung, 1992; Kang, 1993; Markides & Ittner, 1994; Datta & Puia, 1995; Cakici, Hessel, & Tandon, 1996; Conn, Cosh, Guest, & Hughes, 2005; Moeller & Schlingemann, 2005; Doukas & Kan, 2006; Aybar & Ficici, 2009; Feito-Ruiz & Mene´ndez-Requejo, 2009; Chari, Ouimet, & Tesar, 2010; Von-Eije & Wiegerinck, 2010). Most of these studies have used data on US or other developed economy firms, and few strong conclusions may be drawn: some studies report an average share price reaction that is positive and statistically significant; some a reaction that is negative and statistically significant; and others find evidence that is inconclusive. There are a limited number of studies of CM&As by EMNEs, and again the results are mixed. For example Aybar and Ficici (2009)

[2] There is a range of research that has discussed the general benefits of CM&As. Shimizu et al. (2004) proposed three perspectives in understanding CM&As based on the previous literature: CM&As as an international entry mode, learning opportunities of a foreign culture, and a value creation strategy. Additionally, Sun et al. (2012) provides the additional view that CM&As allows MNEs to continue enjoying national industrial factor endowments, as well as a reconfiguration of their value chain and facilitation to overcome institutional constraints. Value creation has been the key perspective in the literature. This paper examines the value creation implications of EMNEs' corporate governance.

[3] This literature appears in both IB and finance journals, and different terminology is often used for the same concepts.

reported an average negative stock market responses to CM&A announcements by a sample of EMNEs from 11 countries, whereas Bhagat et al. (2011) found a significant positive market reaction to announcements in a sample of EMNEs from eight emerging markets. Chen and Young (2010) showed that Chinese acquiring MNEs have negative average CARs, whereas Boateng, Qian, & Tianle (2008) and Kling and Weitzel (2011) showed positive CARs for their samples of Chinese firms[4].

[Insert Fig. 1 around here]

This study focuses on a sample of EMNEs that have cross-listed on the Hong Kong Stock Exchange (HKSE). Previous research (Coffee, 1999; Lang et al., 2003; Stulz, 1999) has suggested that firms that have cross-listed in advanced markets can reduce agency and capital costs by signalling their commitment to comply with the regulatory requirements of the host countries with better investor protection (the so-called bonding hypothesis). Doidge et al. (2004) found that foreign firms cross-listed in the United States had higher firm valuations, as measured by Tobin's q. Sami and Zhou (2008) identified 73 Chinese firms cross-listed on the HKSE, and reported that they had lower information asymmetry risks, lower capital costs, and higher firm values (measured by Tobin's q) than their domestic counterparts. This they ascribed to the increased disclosure and regulatory scrutiny. We therefore hypothesise:

H1. *The average stock market reaction to cross-border acquisitions by EMNEs will be positive.*

[4] In more detail, Aybar and Ficici (2009) analysed 433 CM&A announcements made by 58 EMNEs during the 1991–2004 period, and showed that equity market responses are negative on average to CM&A announcements by EMNEs in 11 countries. Chen and Young (2010) studied 39 deals by 32 Chinese MNEs from 2000 to 2008 and showed Chinese acquiring MNEs have negative average CARs and those with greater government ownership generate lower value returns in CM&As. In contrast, Bhagat et al. (2011) show a significant positive market reaction based on an analysis of 698 CM&A announcements by EMNEs from eight emerging markets from 1991 to 2008. Gubbi et al. (2010) showed that CM&As create significant positive shareholder value for Indian acquiring MNEs using an event study of 425 acquisitions during 2000 - 2007. Kohli and Mann (2012) study a sample of 202 CM&As and 66 domestic M&As, concluding that the former generate superior wealth gains than the latter in India. Boateng et al. (2008) examined a small sample of 27 Chinese CM&As in a short period between 2000 and 2004 and saw positive value creation for acquiring firms' shareholders. Kling and Weitzel (2011) analysed 221 CM&A announcement events of Chinese firms listed in the Hong Kong, Shanghai or Shenzhen stock exchanges between 2001 and 2008 and concluded that CM&As created positive shareholder value but to a lesser extent than domestic M&As.

2.2. Corporate governance determinants of the stock market reaction

The extant literature on the determinants of shareholder wealth effects in CM&As by EMNEs reviewed above focuses primarily on firm-specific and/or bid-specific characteristics, together with country and/or institutional determinants. Few of the studies considered governance variables, either at the national or company level. Bhagat et al. (2011) showed that country-specific governance provisions related to investor protection had a significant positive impact upon shareholder gains. Kling and Weitzel (2011) considered the domestic stock market impact of a small number of firm-specific ownership variables in the context of the internationalization of Chinese firms, whilst Chen and Young (2010) found that large government ownership had a negative impact upon domestic shareholder returns from Chinese CM&As. This research builds upon and extends this line of research. We conjecture that corporate governance variables – and, in particular, variables related to ownership structure, corporate control, and various internal control mechanisms – will affect the size of the stock market reaction to CM&A announcements. The emerging economy context is important in this regard, as it is here that principal–agent (PA) and principal–principal (PP) problems are potentially crucial.

The PA perspective argues that agent discretion is likely to surge due to discrepancies in both information and specialised, localised knowledge between shareholders (principals) and managers (agents). Monitoring and supervision can be particularly difficult and costly. Value creation derived from internationalisation might be compromised by managerial entrenchment when managers attempt to pursue their personal interests through internationalisation such as hubris and ‘‘empire building’’ behaviours (Sanders & Carpenter, 1998; Seth, Song, & Pettit, 2002). In contrast, the principal–principal (PP) perspective focuses on the conflicts between controlling and minority principal shareholders (Lien, Piesse, Strange, & Filatotchev, 2005). It postulates that ownership and control concentration (blockholders) may reduce information asymmetry and free rider issues related to monitoring in firms with widely-dispersed shareholdings (Shleifer & Vishny, 1997). However, the majority

shareholders might attempt to reap the private benefit of control derived from this concentrated owner- ship structure and disregard the interest of minority principals. This goal and interest incongruence between the majority and minority principals can eventually lead to PP conflicts[5]. Fig. 1 provides an illustration of the layout of our hypotheses.

2.2.1. Ownership structure

To study the PP conflicts that affect EMNEs shareholder returns when engaging in CM&As, we first examine the ownership structure, which is an important governance mechanism influencing a firm's strategic decision-making and shareholder value creation, and aligns the interests of stakeholders (Jensen & Meckling, 1976; Shleifer & Vishny, 1997). In emerging economies, a concentrated ownership structure is very common among publicly-listed firms, often due to an absence of effective legal protection of minority shareholders and external governance mechanisms such as product market competition, the managerial labour market, and the threat of takeovers (La Porta, Lopez-de- Silanes, Shleifer, & Vishny, 1997; Masulis, Wang, & Xie, 2007; Morck, Shleifer, & Vishny, 1988).

Given the weak governance and underdeveloped institutional context to minority shareholder protection, shareholder concentration is a rational strategy to monitor and reduce managerial discretion (Dharwadkar et al., 2000). This could minimise the agency costs arising from the PA conflicts, as the controlling shareholder with the largest shareholding is incentivized to collect information, monitor managers as well as bear the risks of pursuing new business ventures. Their significant voting powers as a result of their largest shareholding also give them the ability to ensure managers make investment decisions in the interest of shareholders (La Porta, Lo´ pez de Silanes, & Shleifer, 1999; Shleifer & Vishny, 1997). We therefore hypothesise:

H2a. *The stock market reaction to cross-border acquisitions by EMNEs will be positively related to the shareholding of the largest shareholder.*

[5] See the review by Young et al. (2008) and the discussion below.

However, the possibility for controlling shareholders to reap the benefits of private control is central to PP conflicts. The largest shareholder, having assumed effective control of a firm, can exploit its insider position and discretionary power to extract private benefits that are detrimental to other shareholders and corporate performance. This might be destructive to the market value of firms (La Porta et al., 1999; Morck et al., 1988; Young, Peng, Ahlstrom, Bruton, & Jiang, 2008). Typically through pyramidal ownership and cross-holdings, largest shareholders as the controlling shareholders can gain further control rights that exceed their cash flow rights. This allows them to use minimal capital investment to expropriate minority principals. Such expropriation may take many forms, such as cronyism, transfer pricing, related-party transactions, asset stripping, tunnelling profits etc. (Faccio, Lang, & Young, 2010; La Porta et al., 1999; Liu & Lu, 2007).

Previous research suggests that firms with multiple blockholders have higher firm values than those with a single dominant one (Laeven & Levine, 2008; Maury & Pajuste, 2005). Firms might benefit from effective cross-monitoring as multiple shareholders compete for corporate control and mitigate the expropriation of dispersed minority shareholders (La Porta et al., 1999; Pagano & Ro¨ ell, 1998). They might contest the opportunistic controlling shareholders in favour of value-maximising investment projects, thereby curbing the diversion of corporate resources for private gain and demonstrating a positive effect on corporate risk-taking (Attig, Guedhami, & Mishra, 2008; Mishra, 2011). We thus hypothesise:

H2b. *The stock market reaction to cross-border acquisitions by EMNEs will be positively related to the combined shareholdings of large non-controlling shareholders.*

The presence of institutional shareholders as blockholders has also been suggested as an alternative mechanism to decrease agency costs. With the cost of divesting their large block of shares to both them and the firm, they have the incentives and influence

to improve minority shareholder protection, monitor and affect firm strategy, and push for transparent deals. However, this largely depends on the long or short-term objectives of the institutional investors, and the need to balance their diversified portfolios (Filatotchev & Wright, 2011; Masulis et al., 2007; Tihanyi, Johnson, Hoskisson, & Hitt, 2003). They also provide much needed capital resources for EMNEs to expand internationally. The presence of institutional investors should thus mitigate the expropriation activities of controlling shareholders. We therefore hypothesise:

H2c. *The stock market reaction to cross-border acquisitions by EMNEs will be positively related to the combined shareholdings of institutional investors.*

2.2.2. Corporate control

To further examine the PP conflict, we focus on corporate control. The market value of control varies depending on how minority shareholder perceive the risk of expropriation by the various types of controlling shareholders (such as state, founders, foreign investors), all of which have different strategic goals and decision-making behaviours (Connelly, Hoskisson, Tihanyi, & Certo, 2010; Shleifer & Vishny, 1997). State-owned firms are prone to expropriative behaviour due to issues related to ownership transparency, managerial competence, and a preference for political interests rather than economic gains from internationalisation (Chen & Young, 2010; Tihanyi & Hegarty, 2007). Firms controlled by their founders have a strong incentive to undertake FDI but their minority shareholders are more likely to be exposed to expropriation. This is because the owners tend to retain control by forming close links with trusted corporate insiders and are reluctant to share vital business information with outsiders in order to protect their contracts, property rights and socioemotional endowments (Anderson & Reeb, 2003; La Porta et al., 1999; Wielemaker & Gedajlovic, 2011). Foreign-controlled firms are likely to focus on maximizing returns as they tend to demand better corporate governance by means such as improving transparency and undertaking monitoring activities (Filatotchev, Strange, Piesse, & Lien, 2007). In light of the above discussion, we hypothesise that:

H3a. *The stock market reaction to cross-border acquisitions by EMNEs will be lower if the State is the largest shareholder.*

H3b. *The stock market reaction to cross-border acquisitions by EMNEs will be lower if the founder is the largest shareholder.*

H3c. *The stock market reaction to cross-border acquisitions by EMNEs will be larger if a foreign investor is the largest shareholder.*

2.2.3. Internal control mechanisms

China has adopted a two-tier system for listed companies, with overall direction and monitoring provided by a Board of Directors (BoD) and a Supervisory Board. In the corporate governance literature, the BoD is viewed inter alia as an important internal control mechanism that is intended to safeguard the interests of the shareholders, and reduce the cost of PA conflicts when control and ownership are separated (Jensen & Meckling, 1976). The literature also emphasises the considerable influence that the board has on firms' strategic decisions and general corporate performance (for reviews, see Adams, Hermalin, & Weisbach, 2010 and Aguilera & Jackson, 2010).

Three characteristics of the Board of Directors are important in this context: Board size, the relative independence of the Board, and CEO duality. Cross-border acquisitions involve a great deal of complexity both before the event and during the post-acquisition integration, and this imposes substantial demands upon the managerial capabilities of the acquiring firm. Strategic management research recognises that, in addition to its control function, the Board may also play an important resource/service and support role in the firm decision-making process, and the efficacy with which these roles are undertaken is usually associated with the size of the BoD and the supervisory Board (Hambrick, Geletkanycz, & Fredrickson, 1993). Furthermore, the overall size of the BoD has been shown to influence the quality of monitoring (Yermack, 1996), though the benefits may be offset in part by increased costs of communication (Priem, 1990; Eisenhardt & Schoonhoven, 1990). Board

independence has been found to be an indicative proxy for the quality of corporate governance, which is linked with general firm performance (Bhagat & Bolton, 2008)[6]. The BoD is more likely to ensure that firms' decisions are made in the interests of all shareholders and thus reduce both expropriation by managers and controlling shareholders, if there is a large presence of outside directors (Fama & Jensen, 1983; Jensen & Meckling, 1976; Shleifer & Vishny, 1997). We assume that international investors will take such Board characteristics into account when assessing the prospects of a CM&A, and we thus hypothesise:

H4a. *The stock market reaction to cross-border acquisitions by EMNEs will be higher the larger is the size of the Board of Directors.*

H4b. *The stock market reaction to cross-border acquisitions by EMNEs will be higher the greater the independence of the Board of Directors.*

Notwithstanding the above, various authors have suggested that corporate boards are often ineffective in EMNEs and fail to establish "institutional legitimacy" to oversee private interests of control. Controlling shareholders often use their voting rights to turn the BoD into a 'rubber stamp' authority by appointing board members who will support their decisions (Claessens et al., 2002; Claessens et al., 2000; Peng, 2004; Xiao, Dahya, & Lin, 2004; Young et al., 2008). This is particularly likely in companies where the Chairman of the Board is also the Chief Executive (the case of CEO duality). Chen, Li, & Shapiro (2011) found that CEO duality had an insignificant impact on monitoring expropriation activities of controlling shareholders in China. We thus hypothesise:

H4c. *The stock market reaction to cross-border acquisitions by EMNEs will be lower in companies where the Chairman of the Board is also the Chief Executive Officer.*

[6] In China, Board independence is defined by the Chinese Security Regulation Commission (CSRC) for listed firms in ''Guiding Opinions on Establishing the Independent Director System in Listed Companies 2001''. In Article 1 of the document, an independent director refers to ''a director who does not hold any position in the company other than director and who has no relationship with the listed company engaging him or its principal shareholders that could hinder his making independent and objective judgments."

Many emerging countries have followed the OECD principles and set up supervisory boards to oversee senior management and the Board of Directors. It is now mandatory under Chinese Company Law to have supervisory boards, and also that one-third of the directors should be independent (Chen et al., 2011; Mar & Young, 2001)[7]. As with the BoD, the members of the Supervisory Board may in principle perform an important function in terms of providing strategic information and knowledge that firms can use in their decision-making processes (Hambrick et al., 1993). To this extent, we would expect the stock price reaction to be positively related to the size of the supervisory board. However, there is substantial research to suggest that supervisory boards in Chinese companies are at best likely to be ineffective, and may even have a negative impact upon corporate efficiency. Supervisory boards in China have no power to vote on BoD decisions nor on the selection of BoD members. Chen et al. (2011) thus concluded that supervisory boards had limited effectiveness in mitigating the expropriation activities of controlling shareholders in China. Dahya, Karbhari, Xiao, & Yang (2003) suggested that supervisory boards in China were dysfunctional, and were generally perceived as decorations to the boardroom. Ding, Wu, Li, & Jia (2010) found that large supervisory boards were associated with increased executive compensation and lower pay-performance sensitivity, thus suggesting lower monitoring efficiency. We thus hypothesise that:

H4d. *The stock market reaction to cross-border acquisitions by EMNEs will be lower the larger is the size of the Supervisory Board.*

In advanced countries, the audit committee is an important mechanism within the internal corporate governance of listed companies. The main role of the committee is to be the guarantor of the integrity of the company's financial statements, so that external investors and other stakeholders can have confidence in the financial data with which they are presented. The independence of the committee is taken to be assured by the presence of independent auditors. Furthermore the audit committee

[7] The CSRC published the Code of Corporate Governance in January 2001.

will also submit their work to external auditors, and the latter's remit will include providing assessments of the effectiveness of management's financial management and the committee's work (Chan & Li, 2008, Chen, Firth, Gao, & Rui, 2006). Good independent external auditors charge high fees, especially if they are required to undertake a considerable amount of work. In emerging economies, both the role and the efficacy of these auditing arrangements are less established, nevertheless we hypothesise that international investors will view both with favour:

H4e. *The stock market reaction to cross-border acquisitions by EMNEs will be higher the greater the independence of the audit committee.*

H4f. *The stock market reaction to cross-border acquisitions by EMNEs will be higher the larger the fees paid to external auditors.*

3. Data and methodology

3.1. The construction of the dataset

One of the unique features of EMNEs, particularly Chinese firms, is that they often conduct CM&As via third countries or tax havens (Ning & Sutherland, 2012). Nearly 70% on average of Chinese OFDI stock went to Hong Kong by 2011 and this was the major vehicle for Chinese firms to access global capital (MOFCOM, 2011). Furthermore, the Chinese government has recently proposed a set of policies to encourage more Chinese mainland firms to list in Hong Kong (Financial Time, 2012).

We constructed a unique firm-level dataset from a combination of sources and manually-collected information. All bidding firms had an 'ultimate parent' (controlling shareholder) from Mainland China. These included firms incorporated in China and listed in Hong Kong with H-shares and mainland Chinese companies incorporated and listed in Hong Kong with major business operations in China (also known as "red chip" companies). The initial sample consisted of 405 CM&A announcements made between 1 Oct 1991 and 31 May 2010 by Chinese MNEs listed

on the HKSE. This sample information was extracted from a combination of the Thomson Financial database, Factiva, and news reports as there were a number of missing Chinese CM&A records on Thomson. We required all firms to have at least 120 days stock trading information, and to have been listed on the HKSE for at least one year prior to the acquisition announcements. We obtained firms' stock returns and financial information through DataStream. After excluding companies with missing stock data, we identified 396 CM&As associated with 145 firms. We then excluded CM&As involving 'round tripping' activities by checking the investment destinations of each CM&A deal. This left a sample of 335 acquisition announcements (associated with 137 parents) for the cross-section regression analysis. Corporate governance variables were manually collected from each company's annual reports to match the announcement period. Information from Chinese listed firms about major governance variables such as board and ownership structure has become increasingly available since 1999 when new disclosure regulations were introduced (Chen & Young, 2010).

The use of stock price data from the 'advanced' HKSE has two main advantages compared to analysing comparable data from the domestic emerging economy (i.e. Chinese) stock markets. First and foremost, stock prices in emerging markets are often inadequate measures of firm value due to higher degrees of information asymmetry (Von-Eije & Wiegerinck, 2010). In contrast, the higher disclosure standards on the HKSE should reduce these information asymmetries, with the result that prices should more accurately reflect firm value. Second, domestic Chinese investors are restricted from trading H-shares or investing in Chinese firms directly incorporated and listed in Hong Kong. The HKSE stock prices thus reflect the expectations of international investors, who may be assumed to have many potential investment opportunities and moreover to have the wherewithal to make relatively balanced judgments of the merits of individual CM&A deals.

3.2. Methodology

We adopt cumulative abnormal returns (CARs) on the bidding firms' stock prices around the announcement date as a measure of CM&A performance. The price changes are used to infer investors' reactions (Shleifer & Vishny, 1997). This measure

has been frequently used in the previous finance and management literature, and particularly in the case of EMNEs where firm-level financial and accounting data suffer from availability and reliability concerns (Chen & Young, 2010; Gubbi, Aulakh, Ray, Sarkar, & Chittoor, 2010).

To test Hypothesis 1, we employ a standard event study methodology to assess the CAR of the Chinese acquirer firm around the event day. The event day (t = 0) is the CM&A announcement day. The market equation to compute the abnormal returns is given by:

$$R_{it} = \alpha_i + \beta_i R_{mt} + \varepsilon_{it} \quad (1)$$

where R_{it} is the stock return of bidder i at time t. R_{mt} is the return on a market portfolio, the HangSeng Index, during the period of t. Coefficient α_i is the intercept term and bi captures the systematic risk of the acquirer i's stock. ε_i is the error term in the regression equation. From the estimation of Eq. (1), the daily abnormal return (AR_{it}) for each CM&A event i is calculated as:

$$AR_{it} = R_{it} - (\widehat{\alpha_i} + \widehat{\beta_i} R_{mt}) \quad (2)$$

$\widehat{\alpha_i}$ and $\widehat{\beta_i}$ are the ordinary-least-squares parameters computed through the regression of R_{it} on R_{mt} in Eq. (1) over the 90 trading days, commencing from t = -120 to t = -31 prior to the event[8]. These two coefficients were used to predict the 'normal' return for each day during the event window and then deducted from the observed actual return to compute the daily AR_{it} in Eq. (2). The event window was a symmetric number of

[8] A range of different estimation windows have been used in the previous literature, as Gubbi et al. (2010), Boateng et al. (2008), and McWilliams and Siegel (1997) have pointed out. We used a relatively short (i.e. from t = -120 to t = -31) period to avoid compounding effects that might contaminate the results and lead to more biases, as well as dilute the announcement effects in our estimation. In unreported results, we also re-estimated the CARs using a variety of short and longer (e.g. from t = -270 to t = -21) estimation windows, but our results were robust. These results are available on request from the authors.

days around the event day. This paper uses 2, 3, 5 and 11-day event windows (0, +1), (-1, +1), (-2, +2) and (-5, +5) to measure the short-term market reactions, based on the assumption that the Hong Kong Stock Exchange is a relatively mature and efficient international market. The daily AR_{it} were aggregated over the event window period to calculate the cumulative abnormal returns (CARs). We then checked whether CARs are statistically different from zero using the parametric t-test and the non-parametric Wilcoxon-signed rank test.

For Hypotheses 2–4, the resulting CARs were regressed on the sets of explanatory and control variables to validate the hypothesized shareholder value creation effects of the corporate governance variables (See Table 1 for more details). The multiple regression equation was thus:

$$CAR_i = \alpha + \beta_1 OWN_i + \beta_2 CONTROL_i + \beta_3 ICM_i + \beta_4 IND_i + \varepsilon_i \qquad (3)$$

where CAR_i is the CAR of acquirer *i*; OWN_i are the three variables related to the ownership structure: viz. the percentage of shares held by *the largest-shareholder*, *the other blockholders* (with at least 10% shareholding), and *institutional investors*; $CONTROL_i$ are three dummy variables related to the identity of the controlling shareholder: viz: *state-controlled*, *foreign-controlled*, or *founder-controlled*; ICM_i are the six variables related to internal control mechanisms, viz: board size, board independence, CEO duality, the number of non-executive directors, size of supervisory board, audit committee independence, and audit fees; IND_i are the various independent control variables (see below), viz *firm age*, *firm size*, *Tobin's q*, *leverage*, and the dummy variables *group affiliation*, *public target*, *target region*, and *year effect*[9]. ε_i is the error term.

[Insert Table 1 around here]

[9] The variables used in the robustness tests are not presented in this equation.

3.3. Control variables

In line with the extant literature on CM&As, the regression analysis controls for various firm-specific and deal-specific variables that might affect short-term firm value. The firm-specific variables include firm age, which is normally assumed to have a positive impact (+) due to learning curve effects on firm performance (Sapienza, Autio, George, & Zahra, 2006). We control for the influence on CAR of the firms' past financial and operational performance by including the three-year average returns on assets (ROA) and operating profit margins (OPM). Strong past performances are expected to have positive effects (+). Firm size may be associated with value creation if firms' are able to mobilise their available resources and capabilities to achieve scale economies through M&As, or with value destruction given possible managerial hubris and information asymmetry in target assessment, and challenges for post-acquisition integration (Stulz, 2005). It can therefore have either a positive or negative effect (+/-). We include Tobin's q as a proxy for firms' capitalised capabilities and resources (Dong, Hirshleifer, Richardson, & Teoh, 2006; Doukas & Lang, 2003), though previous research shows mixed results as to its effect on CAR (+/-), Leverage is expected to have a positive effect (+) on CARs as higher debt levels reduce managerial discretion and also show firms' capabilities to access financial resources (Masulis et al., 2007).

One of the main features of the corporate governance environment in emerging economies is the prevalence of business groups (Chang & Choi, 1988; Chang, 2006; Khanna & Yafeh, 2007; Young et al., 2008; Colpan et al., 2010). The potential benefits of business group affiliation are well recognised and include member firms' capabilities to tap the group's capital and managerial resources, the sharing of costs and risks, inter-group transactions such as debt guarantees and internal trade, and the ability to mobilise resources more readily in the external capital market because of privileged access and/or reputation benefits (Chakrabarti, Singh, & Mahmood, 2007). But business group affiliation also has disadvantages. Complex ownership structures – involving inter alia stock pyramids and cross-shareholdings – are commonplace, particularly in Asia (Claessens et al., 2002). There may be agency problems if the objectives of the firm are not the same as those of the controlling group (Shleifer &

Vishny, 1997). Such considerations suggest that international investors may well view group affiliation (-) as exacerbating potential PP conflicts, and reducing the expected gains from CM&As.

The deal-specific variables include the target firms' public status – this affects the acquisition performance due to the different degree of market competition and political costs involved. Acquisitions of publicly-listed firms can lead to significantly negative CARs, whereas positive results are more likely for private targets (Aybar & Ficici, 2009; Fuller, Netter, & Stegemoller, 2002; Moeller, Schlingemann, & Stulz, 2004). We therefore include a dummy variable for the public status of the target firms, and expect public targets to have a negative effect (-). Previous research has also suggested that the payment method for the acquisition may be relevant. We consider three possibilities: payment by cash; payment though stock transfer; and payment by a combination of cash and stock. We take the latter method as the 'base' category, and introduce two dummy variables to indicate whether payment for the CM&A is made by cash or completely through the transfer of stock. Dong et al. (2006) suggest that 100% payment in stock (-) may indicate an overvaluation of the acquirer's stock, and may thus have a negative impact upon stock price, whilst 100% payment in cash (+) is likely to be positively received. Conn et al. (2005) found no stock price reaction difference between the payment methods, but we nevertheless include the dummies to capture any possible effects.

Finally, we also control for the impact of time-varying market-wide performance, and for the general effects related to the target firms' region (Europe, North America, Asia) on stock performance. The governance variables and the independent control variables, and their hypothesised effects upon the stock price reaction, are summarised in Table 1.

3.4. Descriptive statistics

Table 2 presents the summary statistics and the correlation matrix of the variables used in our regression. In line with the previous literature, the average percentage of largest-shareholder ownership concentration in our sample is 56%. The number of directors on the Board is about 12 and around 31% of them are independent directors. Largest-shareholder ownership concentration is positively correlated with CARs. The majority of the correlations are less than 0.4 but to ensure the results will not be affected by multicollinearity, we compute variance inflation factors (VIFs). All VIF values are within an acceptable range (mean 2.63).

[Insert Table 2 around here]

4. Results and discussion

4.1. The stock market reaction to announcements of cross-border acquisitions

To test hypothesis 1, we used a standard event study method to measure the effects of CM&A announcements on the shareholder value of the Chinese acquirer firms. Table 3 reports the CARs for both the total sample of 396 acquisitions and the subsample of 335 acquisitions during the 2-day, 3-day, 5-day and 11-day event windows. For the whole sample, the mean CARs range from 0.61% to 1.05% and are statistically significant over the 2-day ($p < 0.01$, positive yield of 0.91%) and 3-day event windows ($p < 0.01$, positive yield of 1.05%). The mean CARs in the wider event windows are positive at the 10% significance level. This is in line with our expectation that the HKSE is a relatively efficient market. We also employed the non-parametric Wilcoxon signed-rank test to examine the signs of the CARs (McWilliams & Siegel, 1997). The test results are statistically significant and can confirm the dominance of the positive CARs for both 2-day and 3-day event windows. We also applied the same test procedures to our subsample and obtained the same outcome.

[Insert Table 3 around here]

The above results support Hypothesis 1 and indicate that Chinese CM&As, on average, generate positive abnormal returns. The international investors perceive the CM&As as value-creating strategies. These findings are consistent with earlier research for EMNEs in general (Bhagat et al., 2011; Gubbi et al., 2010), and more specifically for Chinese firms based on the response of the domestic stock market (Chen & Young, 2010; Kling & Weitzel, 2011).

4.2. The determinants of the stock market returns related to corporate governance

We now consider the impact of the governance variables on the cross-sectional variation in the CARs of the Chinese acquirer firms – see Table 4. We first regressed the 3-day CARs on the set of independent control variables (Model 1), including a set of dummy variables to capture year effects and the effects of the home regions of the target companies. The coefficient of determination was 0.137, and firm size, firm capabilities and resources (as proxied by Tobin's q), financial performance (as proxied by the return on assets) all have significant negative effects upon the acquirer CARs. The negative and significant coefficient on ROA indicates that international investors perceive large firms may have already exhausted their internal growth opportunities as inferred from the negative impact of ROA on CARs. These results are similar to the findings of Baker et al. (1988), Dong et al. (2006), Moeller et al. (2004) and Moeller, Schlingemann, & Stulz (2005). In contrast, the coefficient of the operating performance (OPM) variable is positive and significant, showing that investors view favourably acquisitions made by companies with high profit margins.

[Insert Table 4 around here]

We next regressed the CARs on the set of independent control together with the corporate ownership variables (Model 2). The inclusion of these variables let to a marked increase in the explanatory power of the model ($R^2 = 0.153$).The coefficient of the largest-shareholder ($\beta = +0.041$, $p < 0.1$) is significantly positive, thus confirming Hypothesis 2a and the propositions of Dharwadkar et al. (2000). It implies that

international investors perceive controlling shareholders can improve the effectiveness of governance, overcoming the PA issues and taking on excessive risks to internationalise. The presence of other large blockholders also has a positive effect on the CARs, but the impact is statistically insignificant (β = +0.021, $p > 0.1$). Hypothesis 2b is thus not supported. It appears as though international investors do not expect large non-controlling blockholders to mitigate the PP problems inherent in firms with concentrated shareholdings. Finally we find a negative but insignificant effect associated with the share ownership of institutional investors (β = -0.037) in Model 2, but both the absolute size and the statistical significance of this coefficient increase when additional explanatory variables are added. Thus the coefficient β = -0.101 ($p < 0.05$) in Model 4, contrary to our prediction in Hypothesis 2c. This implies that greater institutional ownership may not mitigate the expropriation by controlling shareholders. Coffee (1999) also shows that mutual fund shareholders in the Chinese listed firms do not tend to act in favour of other minority shareholders.

At the next stage, we added the three variables related to the identity of the largest shareholder (Model 3). Again there is a marked increase in the explanatory power of the model (R^2 = 0.172). We show that State control (β = -3.799, $p < 0.01$) and founder control (β = -4.149, $p < 0.01$) both have significant negative effects upon the stock price reaction to CM&A announcements, confirming hypotheses 3a and 3b. This suggests that international investors perceive State and/or founder shareholders may have objectives other than shareholder value maximisation, and so react accordingly. Previous studies have also shown that State-controlled firms may be more predisposed to follow their own agenda. Investors might perceive this as allowing bureaucrats to pursue their own social and political objectives and embark on politically symbolic OFDI projects at the expense of firm performance (Chen & Young, 2010; Shleifer & Vishny, 1997). Stulz (2005) termed this situation “expropriation by the state”. This may also reflect the concern of international investors that Chinese MNEs with a governmental controlling shareholder could be caught up with political controversies in foreign countries or suffer from post-acquisition integration failures when they make CM&As. The explanation for the negative impact of corporate founders could be that they are more likely to make decisions without the aid of “outsiders” and alienate outside investors, as concluded by (Wielemaker & Gedajlovic, 2011). Firms

with the founder as the controlling shareholder are more likely to conceal corporate information from the market (Anderson & Reeb, 2003).

We found that control by foreign investors had a negative but insignificant effect on the CARs, thus not supporting hypothesis 3c. The above results together suggest that although shareholders will not avoid investing in these firms, they are aware of the potential for expropriation by controlling shareholders such as the state and founders, and discount the share prices of these firms accordingly. This evidence is consistent with previous research (Chen et al., 2011; Peng, 2004), and provides evidence for the importance of avoiding potential PP conflicts in the value creation of CM&As. It is also interesting to note that group affiliation has a very significant negative effect (β = -3.531, $p < 0.1$) on the CARs in Model 3. This implies that investors suspect that complicated group structures entrench controlling shareholders and increases the possibility of expropriation, thus offsetting the benefits of the internal market for scarce resources within the group (Strange, Filatotchev, Buck, & Wright, 2009).

Finally, we estimated the full model including the control variables, the ownership variables, the corporate control variables, and the six variables capturing different internal control mechanisms[10]. The introduction of these six ICM variables led to a very significant increase in the explanatory power of the model ($R^2 = 0.222$; $F = 4.67$, $p < 0.01$). The control variables all retained their previous signs and significance, except that firm size lost significance whilst the coefficient of leverage became positive and significant ($\beta = 0.011$, $p < 0.05$) as found in earlier work. None of the deal-specific variables were statistically significant. Of more interest is the fact that the coefficient of group affiliation was negative and highly significant ($\beta = -4.567$, $p < 0.01$) confirming that investors perceive potential PP conflicts in firms that are members of business groups. The coefficients of the three ownership and three corporate control variables all retained their previous signs and significance.

[10] Please note the sample size is only 278 due to missing data for some companies.

With regard to the six internal control mechanism variables, we find that both BoD size (weakly) and Board independence (more strongly) have positive and significant effect on the stock price reaction, lending support to hypotheses 4a and 4b. We can also report that the size of the Supervisory Board has a very significant negative impact (β = -0.342, $p < 0.01$), confirming hypothesis 4d, and supporting the views of many authors that supervisory boards may at present be more of a hindrance than a help to good corporate governance in Chinese listed companies. The other three variables (CEO duality; audit committee independence; audit fees) all had the expected signs, but none were statistically significant so hypotheses 4c, 4e and 4f were not supported on the basis of this analysis.

4.3. Robustness checks

The analysis above was undertaken using 3-day CARs as the dependent variable. As a robustness check, we also estimated the regression model using the corresponding 5-day CARs [-2, +2] and the results are reported in Table 5. The results are broadly similar, and indeed most models show slightly higher levels of explanatory power – for example, the coefficient of determination in Model 4 is 0.243 (cf. 0.222 in Table 4). This is reassuring, however none of the six internal control mechanisms are individually statistically significant in this regression notwithstanding the significant increase in the R^2. This could be a result of the relative efficiency of HKSE that leads to a short-term significant reaction. The results nevertheless suggest that further investigation of the impact of internal control mechanisms is still necessary in future research.

[Insert Table 5 around here]

We also estimated the model using additional explanatory variables such as relative deal size, and alternative measures for some control variables. We calculated the relative deal size using the deal value divided by the market value of the acquirer's total assets (Nicholson & Salaber, 2013). Due to missing values, our sample size is

reduced to 172 observations. The main results were largely unaffected[11], whilst the related deal size variable had a negative but insignificant impact on the reported CARs. Further robustness checks were carried out using different measures of firm size, financial and operating performance, but the results remain materially unchanged[12]. Finally we estimated the model omitting the variables related to the targets' regions and deal payment methods, but again the main results were robust.

5. Conclusions

The growth in CM&As from emerging economies has been remarkable. Our knowledge is still limited regarding the value implications of these CM&As and the impact of PA and PP governance conflicts on the value variations, particularly how this relationship is perceived by international investors. This paper makes an attempt to study the impact of various corporate governance characteristics on the stock price reactions of a sample of Chinese MNEs listed or incorporated on the HKSE.

As HKSE-listed Chinese firms have committed to higher governance standards by listing in an international market and complying with the stricter foreign disclosure requirements, they should benefit from an enhanced information environment and improved transparency, thereby reducing expropriation risks. Our findings firstly indicate that overseas stock markets reward these firms with positive shareholder returns upon the announcement of cross-border takeovers. Secondly, we examined the effects of potential PA and PP governance conflicts on the variation in the MNEs' stock performance following CM&As. After controlling for a range of other possible firm-specific effects, we found there are significant relationships between the announcement returns, the ownership structure and the identities of the controlling share- holders. We found that international investors perceive that a high level of largest-shareholder ownership concentration creates value, but also raises the risk of expropriation of minority principals, which is particularly pronounced in state-controlled and founder-controlled firms. International shareholders discount share prices as a consequence of these perceived corporate governance issues. Third, we

[11] For brevity, the results are not reported but are available upon request.
[12] The results are available from the authors on request.

show that the PP and PA conflicts may be mitigated by a large and independence Board of Directors, but that supervisory boards (at least in the Chinese context) appear to exacerbate rather than assuage international investors' fears of conflicts.

Our research results have an important implication for the corporate governance literature in that we demonstrate how various governance variables affect the shareholder wealth effects of EMNEs' internationalisation via CM&As, as perceived by international investors. Research rooted in agency theory suggests that effective corporate governance can increase shareholder returns through minimizing PA conflicts. Building on this work, we postulate that effective corporate governance can reduce the internal costs of aligning different stakeholders' interests and risk preferences, and of coordinating organisational activities across borders. Nevertheless, although many EMNEs may have adopted many of the features of Anglo-American corporate governance, the mechanisms do not necessarily function as supposed in emerging economies. Their external governance mechanisms, market institutions, and minority shareholder protection are limited and less effective. Block shareholder ownership concentration becomes necessary to constrain agent discretion, improve firms' risk-taking abilities and reduce the internal transaction costs derived from coordination among shareholders when firms are engaged in CM&As.

However, this concentrated structure runs the risk of expropriation of minority equity principals. Given the prevalence of concentrated ownership in EMNEs, the PP rather than PA conflicts are often overlooked as a major issue that affects the shareholder value creation effect of CM&As as perceived by international investors. Our results suggest that investment returns may be disproportionately distributed between controlling shareholders and minority equity investors. As international investors discount the share prices of EMNEs with potential PP conflicts, and thus increase the cost of capital of these EMNEs, the controlling shareholders will eventually bear some of the costs of the PP agency issues.

This paper is not without limitations. We summarize these as follows along with some suggestions for future research areas. Firstly, the value creation or destruction needs to be interpreted cautiously. Although the event study method is generally regarded as a reliable measure for CM&A's market value implications, it is based on the efficient market hypothesis that the stock market reacts instantly and completely to firms' strategic decisions (Gubbi et al., 2010; Kale, Dyer, & Singh, 2002). We also focus on the value consequences from the perspective of international bidders. The degree of information asymmetry, complications in the firm takeover events, and the market knowledge of international investors could lead to some degree of heuristic bias. Future research might need to take into account these methodological constraints. Secondly, CM&As by EMNEs are a relatively new phenomena and their frequency is still relatively low compared the frequency of CM&As by MNES of developed countries. This leads to the sample size of this paper being small compared to studies on CM&As by developed country MNEs. Moreover, the financial reporting practices of EMNEs as seen in this study have resulted in many missing variables, although manual collection of the data used in this paper has minimised this problem[13]. In the future this issue may be resolved as the globalisation of business progresses and the adoption of international business practices by EMNEs becomes widespread. Future studies might be in a better position to re-examine some of the governance and value creation issues related to CM&As, with a longer sample period and more observations. Cross-country studies of EMNEs' CM&As through third countries might reveal an even more comprehensive picture and offer more theoretical explanations for such events.

[13] For example, we would have liked to include relative deal sizes despite the fact that previous research (Aybar & Ficici, 2009; Nicholson & Salaber, 2013) has shown that this variable may be less relevant for EMNEs than for developed country firms, but we have a large number of missing values. We have therefore not included this variable to maintain our sample size. Future research might be able to overcome these data restrictions when more corporate information of EMNEs becomes available.

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Fig. 1. The hypothesised determinants of shareholder value creation as perceived by international investors. Note: Corporate governance related determinants are examined from the perspective of ownership structure, characteristics of control and internal control mechanisms and indicated in dashed lines.

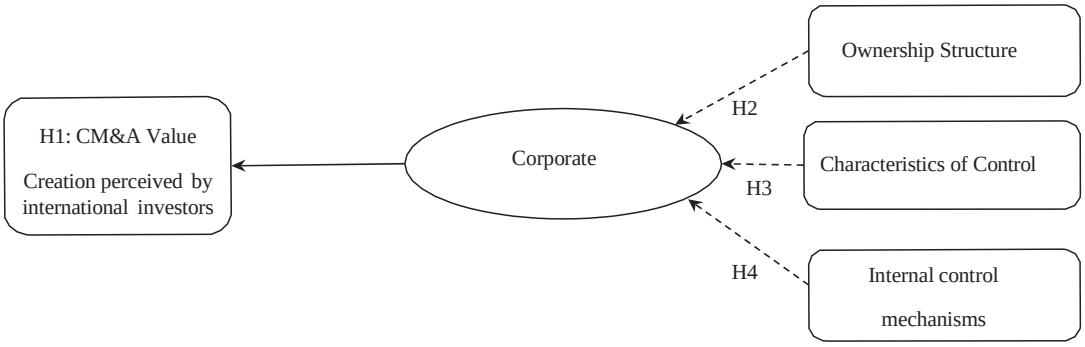

Table 1 Variable descriptions

Variables	Expected sign	Description
Dependent Variables		
CAR (-1,+1)	(+)	Cumulative abnormal return of acquiring firms calculated based on the market model during the 3 days around the acquisition announcement
Ownership structure		
Largest shareholder	(+)	Percentage of shares held by firms' largest shareholder with at least 10% of shares
Other blockholders	(+)	Cumulative percentage of shares held by all blockholders with at least 10% of shares, other than the largest shareholder
Institutional investors	(+)	Cumulative percentage of shares held by institutional investors (%)
Ownership Characteristics		
State controlled	(-)	Dummy variable: 1 for the state being the largest shareholder, 0 otherwise
Foreign controlled	(+)	Dummy variable: 1 for the foreign investor being the largest shareholder, 0 otherwise
Corporate founder controlled	(-)	Dummy varible:1 for the corporate founder being the largest shareholder, 0 otherwise
Board structure		
Board size	(+)	Number of directors on bidders' board
Board independence	(+)	Ratio of independent outside directors (%)
CEO/chairman duality	(-)	Dummy variable: 1 if the bidder CEO is also chairman of the board, 0 otherwise.
Size of supervisory board	(-)	Number of supervisors
Audit committee independence	(+)	Ratio of independent auditors on the audit committee (%)
Audit fees	(+)	Log of the amount of fees paid to auditing firms
Control Variables		
Firm age	(+)	Year of incorporation to year of acquisition
Firm Size	(+/-)	Log of total assets at the end of last fiscal year before acquisition
Tobin's q	(+/-)	Market value of assets over book value of assets
Leverage	(+)	Percentage of total debt over total equity (%)
ROA	(+)	3 year average return on assets (%)
OPM	(+)	3 year average operating profit margin (%)
Group affiliation	(-)	Dummy variable: 1 for group affiliated, 0 otherwise
Public target	(-)	Dummy variable: 1 for public target firms, 0 otherwise
Targeted regions	(×)	Dummy variable for each different regions in Europe, North America, Asia
Year effect	(×)	Dummy variable for each year in the sample period
Stock payment	(+/-)	Dummy variable: 1 for stock payment, 0 otherwise
Cash payment	(+/-)	Dummy variable: 1 for cash payment, 0 otherwise

Note: Firm size in millions and audit fee is in thousands of Yuan. general control variables used in the regression equation.

Table 2 Descriptive statistics and correlations

		Mean	SD	1	2	3	4	5	6	7	8	9	10	11
1	CAR (-1,+1)	1.11	7.94	1										
2	State controlled	0.78	0.41	0.02	1									
3	Foreign controlled	0.04	0.21	0.02	-0.42	1								
4	Corporate founder controlled	0.08	0.27	-0.02	-0.55	0.28	1							
5	Largest shareholder	56.44	16.69	0.06	0.25	-0.29	-0.28	1						
6	Other blockholders	4.04	8.76	-0.06	-0.19	0.07	0.29	-0.50	1					
7	Institutional Investors	7.78	18.68	-0.07	-0.54	0.03	-0.05	-0.03	0.15	1				
8	Board size	11.45	2.93	-0.01	0.10	-0.06	-0.25	-0.05	-0.16	0.01	1			
9	Board independence	31.15	11.35	0.08	-0.04	0.17	0.17	-0.03	0.04	0.02	-0.46	1		
10	CEO/Chairman Duality	0.23	0.42	-0.04	-0.01	0.18	0.12	-0.26	0.23	-0.05	-0.11	0.30	1	
11	Audit fees	21,311.75	37,217.56	-0.05	0.16	-0.21	-0.19	0.34	-0.23	-0.03	0.39	-0.08	0.11	1
12	Size of supervisory board	2.86	3.58	-0.10	0.16	-0.02	-0.12	0.00	-0.06	-0.06	0.35	-0.03	-0.07	0.56
13	Audit committee independence	85.51	22.54	0.10	0.08	0.10	0.00	0.21	-0.04	-0.19	-0.19	0.21	0.09	0.05
14	Group affiliation	0.94	0.24	-0.02	-0.04	-0.15	0.02	0.45	-0.36	-0.22	0.08	-0.12	-0.15	0.25
15	Firm age	13.75	12.07	-0.12	-0.21	-0.01	-0.04	-0.04	-0.11	0.28	0.14	-0.18	-0.16	-0.14
16	Firm Size	419,000	1,470,000	-0.09	0.09	-0.25	-0.29	0.28	-0.27	0.17	0.46	-0.06	0.06	0.83
17	Leverage	66.12	82.94	0.02	-0.17	-0.09	-0.10	-0.13	-0.08	0.32	0.19	-0.10	-0.13	0.04
18	Tobin's q	1.38	4.05	0.00	-0.18	0.47	0.31	-0.07	0.13	-0.03	-0.15	0.08	0.09	-0.18
19	OPM	11.88	36.61	-0.01	0.14	-0.37	-0.04	0.16	-0.03	0.09	0.14	0.05	0.16	0.29
20	ROA	7.18	9.54	-0.14	0.21	-0.41	-0.09	-0.01	0.22	-0.09	-0.05	0.16	0.35	0.27
21	Public target	0.4	0.49	-0.10	0.06	-0.14	-0.09	-0.02	0.04	0.08	0.14	-0.12	-0.07	0.06
22	stock payment	0.03	0.16	0.14	-0.03	-0.02	0.11	0.06	0.04	0.03	-0.13	0.07	0.03	-0.09
23	cash payment	0.36	0.48	-0.11	-0.03	-0.02	0.02	-0.03	0.05	-0.01	-0.08	0.03	-0.04	-0.09

		Mean	SD	12	13	14	15	16	17	18	19	20	21	22
12	Size of supervisory board	2.86	3.58	1										
13	Audit committee independence	85.51	22.54	-0.14	1									
14	Group affiliation	0.94	0.24	-0.09	0.19	1								
15	Firm age	13.75	12.07	-0.22	-0.24	0.14	1							
16	Firm Size	419,000	1,470,000	0.51	-0.10	0.20	0.04	1						
17	Leverage	66.12	82.94	0.13	-0.18	0.04	0.17	0.32	1					
18	Tobin's q	1.38	4.05	-0.01	0.05	-0.11	-0.05	-0.32	-0.12	1				
19	OPM	11.88	36.61	0.06	-0.06	0.20	-0.01	0.36	0.01	0.02	1			
20	ROA	7.18	9.54	0.08	0.05	-0.01	-0.17	0.30	-0.19	-0.27	0.58	1		
21	Public target	0.4	0.49	0.11	-0.18	-0.08	0.07	0.10	0.16	-0.09	-0.01	0.02	1	
22	stock payment	0.03	0.16	-0.08	0.07	0.03	-0.02	-0.12	-0.15	-0.03	-0.04	-0.09	-0.02	1
23	cash payment	0.36	0.48	-0.05	-0.10	0.07	0.09	-0.05	0.00	-0.03	0.07	0.14	0.30	-0.08

Notes: Firm size in millions and audit fee is in thousands of Yuan. Correlations > 0.10 in magnitude are statistically significant at the 0.05 level or higher.

Table 3 Cumulative abnormal returns around the CM&A announcement days

CAR	Mean%	Median %	%positive	t statistics	Wilcoxon signed rank test
Panel A Cumulative Abnormal returns (N=396)					
CAR (0,+1)	0.91	0.46	55%	2.77***	2.52**
CAR (-1,+1)	1.05	0.06	51%	2.67***	1.97**
CAR (-2,+2)	0.61	-0.23	48%	1.34*	0.53
CAR (-5,+5)	0.84	-0.08	49%	1.31*	0.66
Panel B Cumulative Abnormal returns (N=335)					
CAR	Mean%	Median %	%positive	t statistics	Wilcoxon signed rank test
CAR (0,+1)	0.92	0.43	56%	2.52***	2.41**
CAR (-1,+1)	1.11	0.04	51%	2.55***	1.98**
CAR (-2,+2)	0.68	-0.22	48%	1.35*	0.69
CAR (-5,+5)	1.11	-0.04	50%	1.58*	1.01

Notes: *** $p<0.01$, ** $p<0.05$, * $p<0.1$

Table 4 Cross-sectional regression of CARs[a] on corporate governance variables

	Model 1		Model 2		Model 3		Model 4	
Board size							0.333*	(0.184)
Board independence							0.110**	(0.054)
CEO/Chairman duality							-0.167	(1.168)
Audit fees							0.756	(0.784)
Size of supervisory board							-0.342***	(0.116)
Audit committee independence							0.002	(0.016)
State controlled					-3.799***	(1.334)	-4.340**	(1.776)
Foreign controlled					-0.690	(1.979)	-0.580	(2.190)
Founder controlled					-4.149***	(1.115)	-4.232***	(1.403)
Largest shareholder			0.041**	(0.020)	0.056**	(0.023)	0.080**	(0.035)
Other blockholders			0.021	(0.053)	0.021	(0.051)	0.075	(0.071)
Institutional investors			-0.037	(0.027)	-0.088**	(0.033)	-0.101***	(0.040)
Firm age	-0.062	(0.038)	-0.034	(0.043)	-0.040	(0.046)	-0.033	(0.045)
Firm size	-0.464**	(0.224)	-0.476**	(0.223)	-0.606**	(0.225)	-0.894	(0.592)
Leverage	0.002	(0.004)	0.005	(0.004)	0.006	(0.003)	0.011**	(0.005)
Tobin's q	-0.226**	(0.086)	-0.240**	(0.096)	-0.251***	(0.088)	-0.267**	(0.109)
Group affiliation	-0.200	(0.918)	-2.069*	(1.163)	-3.531***	(1.205)	-4.567***	(1.446)
OPM	0.030***	(0.009)	0.034***	(0.010)	0.042***	(0.010)	0.040***	(0.011)
ROA	-0.155***	(0.050)	-0.170***	(0.050)	-0.175***	(0.046)	-0.202***	(0.061)
Public target	-0.946	(0.781)	-0.956	(0.777)	-0.908	(0.805)	-0.602	(0.809)
Stock Payment	5.456	(7.674)	5.856	(7.501)	6.722	(7.081)	7.369	(6.840)
Cash Payment	-0.251	(0.766)	-0.079	(0.754)	-0.154	(0.742)	0.260	(0.859)
Year effect	Yes		Yes		Yes		Yes	
Targets' regions	Yes		Yes		Yes		Yes	
Constant	9.582***	(2.865)	8.978***	(2.563)	15.431***	(2.712)	3.03	(5.896)
Observations	301		301		301		278	
R-squared	0.137		0.153		0.172		0.222	

Notes: Robust standard errors in parentheses, *** $p<0.01$, ** $p<0.05$, * $p<0.1$.

[a] Three-day event window. We control for the impact of time-varying market wide performance and adjust t-statistics for industry clustering across all models.

Table 5 Robustness check 5 day CARs[a]

	Model 1		Model 2		Model 3		Model 4	
Board size							0.282	(0.280)
Board independence							0.041	(0.086)
CEO/Chairman duality							0.889	(1.245)
Audit fees							1.604	(1.023)
Size of supervisory board							-0.270	(0.195)
Audit committee independence							0.002	(0.018)
State controlled					-4.647***	(1.462)	-4.754**	(1.940)
Foreign controlled					-1.102	(2.139)	-1.233	(2.407)
Founder controlled					-8.825***	(1.752)	-8.847***	(2.152)
Largest shareholder			0.075***	(0.023)	0.082***	(0.028)	0.094**	(0.040)
Other blockholders			0.003	(0.055)	0.015	(0.049)	0.015	(0.071)
Institutional investors			-0.049	(0.029)	-0.110***	(0.037)	-0.106**	(0.045)
Firm age	-0.044	(0.046)	-0.001	(0.051)	-0.014	(0.052)	-0.008	(0.045)
Firm size	-0.677**	(0.310)	-0.724**	(0.274)	-0.986***	(0.286)	-1.920*	(0.980)
Leverage	-0.001	(0.004)	0.004	(0.004)	0.005	(0.004)	0.012*	(0.007)
Tobin's q	-0.341***	(0.115)	-0.355**	(0.132)	-0.326***	(0.103)	-0.364***	(0.124)
Group affiliation	-0.571	(1.223)	-3.865**	(1.554)	-4.837***	(1.542)	-6.123***	(1.862)
OPM	0.054***	(0.014)	0.057***	(0.017)	0.070***	(0.015)	0.069***	(0.017)
ROA	-0.249***	(0.084)	-0.261***	(0.089)	-0.281***	(0.076)	-0.291***	(0.104)
Public target	-0.546	(0.961)	-0.538	(0.939)	-0.513	(0.982)	-0.840	(1.081)
Stock payment	0.739	(7.140)	1.380	(7.249)	3.035	(7.463)	3.604	(7.130)
Cashpayment	0.155	(0.989)	0.488	(1.010)	0.344	(0.994)	0.748	(1.146)
Year effect	Yes		Yes		Yes		Yes	
Targets' regions	Yes		Yes		Yes		Yes	
Constant	-5.675	(7.004)	-9.182	(6.249)	1.444	(7.655)	20.264**	(7.913)
Observations	300		300		300		277	
R-squared	0.134		0.162		0.200		0.243	

Notes: Robust standard errors in parentheses, ***$p < 0.01$, **$p < 0.05$, *$p < 0.1$.

[a] Five-day event window. We control for the impact of time-varying market wide performance and adjust t-statistics for industry clustering across all models.