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"Bid Premium in Chinese outbound M&A"

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Abstract

In this paper we study whether Chinese firms bid higher on average when involved in outbound mergers and acquisitions, compared to bidders from the rest of the world. We argue that the unique Chinese context due to the country's spectacular economic growth and communist state control provide Chinese firms with different premises than firms in other parts of the world, and that this might affect the bid premium. Using a sample of 12.700 transactions between 1986 and 2011, collected from Thomson Financial SDC we find evidence that Chinese firms do pay a higher premium for target firm in specific industries such as Mining and Construction. We also find that Chinese firms pay a higher premium when involved in outbound mergers and acquisitions after the financial crisis in 2008.

Content

1. Introduction

Under the headline "China buys up the world" in The Economist, November 2010, the author expresses "*In theory, the ownership of business in a capitalist economy is irrelevant. In practice, it is very often controversial. … China's state-owned companies are on a shopping spree.*" He further argues that Chinese buyers, often run by the Communist Party and sometimes driven by politics as well as profit, have accounted for a tenth of cross-border deals by value this year (2010), "*bidding for everything from American gas and Brazilian electricity grids to a Swedish car company, Volvo*".

Extensive research can be found on merger and acquisitions in general, in particular acquisition activity and merger waves, the value creation effects of M&A, and on the determinants of the takeover premium[1]. Much of the existing literature about the bid premium has focused on macroeconomic factors, ownership structure and deal specific characteristics such as deal type and method of payment, etc. Limited research has investigated the relationship between country specific factors and the bid premium. There exist academic articles in the field of International Business Management, and also non-academic articles stating that Chinese firms do tend to overpay when acquiring companies abroad (Ma and Andrews-Speed 2006, McKinsey 2008). This is also a common presumption among people in the world of finance, and other industries e.g. the Norwegian oil and gas sector. Hence the purpose of this study is to investigate whether or not Chinese bidders to a higher extent pay a premium when acquiring firms in other countries, compared to bidders in general. No previous studies in the field of Finance have been found with this focus.

Using a sample of 12.700 transactions between 1986 and 2011, collected from Thomson SDC we find evidence that Chinese firms do pay a higher premium for target firms in the specific industry-group "Mining and Construction", comprising metal mining, crude petroleum and natural gas, drilling oil and gas wells, mining and heavy constructions. This premium is 32.8 percent higher compared to the takeover premium in all other deals. Our research also finds evidence that Chinese

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[1] In this thesis premiums, bid premiums, acquisition premiums and takeover premiums is used interchangeably to describe the purchase price above the market value.

bidders pay a 50.4 percent higher premium when involved in outbound mergers and acquisitions after the financial crisis in 2008, compared to all other transactions.

These findings are in line with the very limited research (Ma and Andrews-Speed 2006) stating that Chinese national oil companies involved in oversees mergers and acquisitions "overbid" in these transactions. This behavior have according to the authors a number of causes relating to their commercial world view, their strategy, their inexperience and the role of the government; Chinese national oil companies are not primarily answerable to public shareholders with shorter time horizon and are not overwhelmed by fear of failure. Also a McKinsey report (2008) suggests that Chinese acquirers tend to overpay in more than half of all the deals and that capital markets on average discount the value of the combined entities.

In this study, we do not find any evidence suggesting that Chinese bidders in general, during the full sample period pay a higher premium.

This thesis consists of seven sections which will be presented as follows. First, a literature review will be presented. The main part in this section contains relevant background on M&A and different studies about the determinant of the bid premium will be accounted for. In the second part, a selected range of articles from the International Business Management field is included to give some understanding for why China might be considered "a special case". A summary of arguments for the hypotheses and hypotheses will be presented in the third section. In Section 4 first, the dependent and independent variables as well as the method used to investigate the hypothesis are described, and secondly, the data will be presented. The execution and results will be displayed and tested in section 5, while the final conclusion is presented in Section 6.

2. Literature Review

This section will first provide a short summary of the value creating effects of mergers and acquisitions. This will be followed by a summary of research about the known determinants of the bid premium. This part is important in order to illustrate which factors that are previously proven to influence the bid premium, and hence are of importance for our methodology, when aiming to isolate the effect of the acquirer being Chinese. The final section presents literature from the field of International Business Management on the determinants of Chinese outbound M&A, with the purpose to introduce the motivations for Chinese firms to pay a premium, which again provide support for our hypothesis.

2.1 Value creation through Mergers and Acquisitions

The question of whether acquisitions create value has been debated by academics and other researchers for decades. It can be argued that acquisitions create value for the target shareholders based on the fact that the average acquisition premium is about 30 percent above the pre-announcement share price (Koller et al. 2010).

Roll (1986) was the first to suggest that bidder's overconfidence may go a long way in explaining the surprisingly low bidder takeover gains. He formed the Hubris hypothesis, which implies that individual decision makers in bidding firms may pay a premium to acquire an asset that the market has already correctly valued for their own personal motives. Bidding firms infected by hubris simply pay too much for their targets.

Martynova and Renneboog (2008) summarize previous research about value creation in merger and acquisition activity. They find that researchers indicate that even if takeovers trigger substantial value increase at their announcement, most of these gains are captured by the targets' shareholders. There are varying magnitude related to these gains and their distribution between target and bidder shareholders vary across decades and depend on the deal type. All in all, increase in the market values of the combined firms does not support the anticipated synergistic gains. A substantial decline in the acquiring firms' share price is observed over the first five years subsequent to the event.

2.2 Determinants of the bid premium

While there are extensive research covering M&A in general and the reasons behind acquisition activity as well as the value creation effects of mergers, less attention has been given to explanation of variations in the takeover premium. In theory, the highest premium a value maximizing bidder would pay for a firm equals the net benefits of the synergies expected from the combined entity. This would result in a net present value transaction of zero for the bidder and therefor the actual bid is expected to be below this level (Walkling and Edmister 1985). Potential bids below the current market price is abandoned in literature (Roll 1986) since rational target shareholder would turn down offers to buy their shares below what is expected in an arm's length transaction on the stock exchange. This gives us a natural range for both the bid and the bid premium.

Exhibit 2.1 below summarizes prior research on determinants of the acquisition premium. These studies will be discussed in more detail.

2.2.1 Summary of research about the bid premium

Author	Method	Data Sample	Premium definition	Significant variables +/-
Bates & Lemmon (2003)	OLS Regression	3,037 takeovers during 1989 and 1998.	Bid price/Market price 42 days prior announcement.	Target termination fee Indicator (+), Bidder termination fee Indicator (-), Stock offer (+), Tender offer (+), Bidder toehold (+), Log market value of equity (-)
Betton, Eckbo and Thorburn (2008b)	Regression	5,921 takeovers between 1980 and 2002.	Bid price/ Market price 42 days prior to announcement	Bidder is a public company (+), cash offer (+), Run-up (+), Mark-up (-)., Target B/M exceeds Industry B/M (-), Tender offer (-), Positive toehold (-)
Billett and Ryngaert (1997)	NLS Regression	145 cash tender offers during 1980-1989	Bid price/Market value prior to announcement	Multiple bidders (+), Liabilities/Equity (+), Financial assets/Equity (-), Percentages of shares sought (+)
Dionne, La Haye & Bergerès (2011)	Regression	1026 takeover transactions, American	Bid price/ Market price 42 days prior to announcement	Blockholders (-), Sales growth (-), Size (-), Public purchase offer (+), Hostility (+)

		public targets		
Flanagan & O´Shaughnessy (2003)	Regression	285 US tender offers in manufacturing industry between 1986-1995	Bid price/Market price 4 weeks prior to announcement	Percent of target held (-), White Knight (+), Multiple bidders (+), Core-related (+)
Hope, Thomas & Vyas (2010)	Regression	During 1990 - 2007	Bid price per share / target closing price 4 weeks prior to the bid announcement.	Developing countries (+), Target shareholder protection (+), Net assets (-), Profit margin (+), %Sought (+), Competing bid (+), Financial buyer (-)
Li, Levi & Zhang	Regression	458 acquisition bids	Bid price/ Market price 4 weeks prior to the bid announcement	Bidder % female CEO (-), All Stock (-), Bidder ROA (+), Tender offer (+)
Moeller (2005)	OLS regression	373 US transactions 1990-1999	Bid price/Market price 6 days prior to announcement	Target shareholder control (+), Hostile bid (+), Fraction paid with cash (+), MV Target/MV Bidder (-)
Ross and Volpin (2004)	Regression	4007 transactions during 1990 and 1999	Bid price/Market price 4 weeks prior to announcement	Shareholder protection (+), Target size (-), Cross-border (+), Tender offer s (+), Opposing bid (+),
Walkling and Edmister (1985)	Regression	108 US tender offers between 1972-1977	Bid price/Market price 14 days prior to announcement	Debt/Assets (-) , Market Value/Book Value (-), Opposing bidder (+), Control of 50% sought (+), % of shares controlled (-)

2.2.2 Previous research

Walkling and Edmister (1985) investigate 108 US cash tender offers between 1972 and 1977, where they aim at answer the hypotheses; that premium size is a positive function of potential acquisition related benefits, and a negative function of the bargaining power of the bidder. They construct a cross-sectional regression model including the target firm's debt, the target firm's net working capital, bargaining strength variables, such as the percentage of target shares controlled by the bidder prior to the offer (toehold), and valuation related variables to explain

the premium. With a bulk of premiums lying in the 20 to 50 percent range, they find that firms with declining amounts of leverage and firms with relatively low valuations ratios command significantly higher premiums. Bargaining strength (the percentage of shares controlled) and the ability to acquire enough shares to be able to implement potentially beneficial changes (control of 50% Sought) is also significant.

Billett and Ryngaert (1997) have developed a model that demonstrates a direct link between the percentage premium paid and two factors that had not been examined before: shareholders and the target firm's capital structure and asset structure. The hypotheses they lay out are based on two arguments. First, the use of debt financing serves to increases the takeover premiums paid to shareholders because an improvement in the target's assets through redeployment, which is independent of the firms financing structure, because the premium is spread over a smaller equity base. The second argument is that the premium will be smaller for firms with a higher ratio of financial assets to equity. The authors argue that, takeovers of non-financial firms generally takes place because the bidder believes it can better utilize the non-financial assets of the target as opposed to the target's financial assets. Using a sample of 145 cash tender offers for publicly traded companies during the period 1980 and 1989, they find that firm asset structure and capital structure have a significant impact on percentage tender offer premiums paid to shareholders. Tender offer premiums increase with a target firm's liability to equity ratio and decrease with target firm's financial asset to equity ratio.

This result is somewhat contradictive to conventional wisdom of takeovers that view firms with low debt level and high ratio of financial assets as attractive targets, which is discussed by Walkling and Edmister (1985). The inverse relationship between the bid premium and the target firm's financial asset to equity ratio is thus in line with Roll's hubris hypothesis (Roll 1986). The severity of the winner's curse, and hence the degree of overpayment, increases in the variance of the of the bidders' estimates of target value. In this case, the variation in these estimates may be smaller for firms with easier to value financial assets, leading to less overpayment, smaller takeover premiums and the inverse relation between the targets' takeover premium and its proportion of financial assets.

Flanagan and O'Shaughnessy (2003) examine the relationship between core-relatedness and multiple bidders on the takeover premium in 285 tender offers in the US manufacturing industry during 1986 and 1995. In a core-related M&A, the primary business of the acquirer is the same which means vertically connected to or similar to the primary business of the target firm. The authors find a significant interaction effect between multiple bidders and core-related acquisitions. In the absence of multiple bidders, the premium is significantly higher when the transaction is not core-related.

Betton, Eckbo, and Thorburn (2008b) investigate cross-sectional determinants of the bid premium by analyzing 5,921 targets between 1980 and 2002. They categorize explanatory variables into "Target characteristics", "Bidder characteristics", and "Deal characteristics" and their main findings are as follows; First, the initial and final offer premiums are higher after the 1980s, when the bidder is a public company; when the initial bid is an all-cash offer, and the higher the pre-bid target run-up. Secondly, important findings from this study are that the initial and final offer premiums are lower the greater the target total equity capitalization prior to the initial bid; when the target's book-to-market ratio (B/M) exceeds the industry median B/M; when the initial bid is a tender offer; and when the initial bidder has a positive toehold. Thirdly, the initial and final offer premiums are unaffected by the presence of a target poison pill, a target hostility to the initial bid; the presence of multiple bidders; and whether the takeover is horizontal (Betton et al. 2008b).

Levi, Li, Zhang (2008) combine data from both SDC and RiskMetrics Group and suggest that the takeover premium are influenced by the gender composition of the board. Accurately, bid premiums are lower when the CEO of the acquiring firm is female, and the higher the target board's proportion of female directors.

When it comes to examining country- or region-specific factors and difference in the bid premium, it has been difficult to find a lot of research. Rossi and Volpin (2004) study the determinants of mergers and acquisitions around the world by focusing on differences in law and regulations across countries. They find that the volume of M&A activity is significantly larger in countries with better accounting

standards and shareholder protection, and also that the bid premiums is higher in countries with higher shareholder protection.

Thus, more relevant to our research question; Hope, Thomas and Vyas (2010) aim at analyzing if the higher bids by firms from developing countries are affected by national pride, and in doing so, tests their data on bid premiums between developing and developed countries using an extensive amount of control variables. By doing so, they find that the bid premiums in transactions with bidding firms from developing countries, where the target is located in a developed country, are higher than the bid premium in outbound M&As from developed countries.

2.3 Determinants of Chinese mergers and Acquisitions

A growing number of articles have been published the last years which looks at the motivations of Chinese firms to expand internationally. Most researchers (Buckley et al. 2007, Morck, 2007, etc) agree that classical motivations in the international business management field do play the key role: Chinese firms are to various extents market-seeking, resource-seeking, and strategic asset-seeking. However, these characteristics, originally developed in a Western context and for Western companies, do not completely reveal all motivations of Chinese outbound investments (Gugler and Boie 2008).

Buckley et al. (2007) argue that there are three potential arguments to why foreign direct investments (FDI) from emerging economies and China in particular require a different approach than theory applied to industrialized countries. These are; capital market imperfections, the special ownership advantages of Chinese multinational corporations and institutional factor.

Capital market imperfections, which implies that capital is available at below market rates for a considerable period of time, exists in China for a number of particular inter-related reasons; Warner et al. (2004) and others suggests that state-owned (and state-associated) firms may have capital made available to Chinese firms at below market rates. They also points at the fact that inefficient banking systems may make soft loans to potential outward investors. Third, conglomerate

firms may operate an internal inefficient capital market that subsidizes outflow M&A's (Liu 2005), and finally, family-owned firms may have access to cheap capital from family members. Buckley et al. (2007) argue that there are good reasons to believe that all four of these imperfections exist in China. "State-sponsored soft budget constraints make acquisitions by Chinese firms a normal mode of entering and penetrating a host economy." (Buckley et al. 2007, 7)

Ma and Andrews-Speed (2006) specifically discuss the reasons why Chinese national oil companies "overbid". They lists reasons in addition to capital market imperfection as already mentioned above, such as: their commercial world view, their strategy, their inexperience and the role of the government. Close support from the Chinese government may indeed lower the political risk in some countries, which combined with access to loans from state-owned commercial banks will result in China's national oil companies having a lower cost of capital than international oil companies. The authors addresses the question on which cases of "overbidding" are the result of deliberate strategy and which are the result of inexperience, as one of their major questions.

2.4 Summary of literature review

Previous research on the bid premium is of great importance when aiming at constructing the best model for our analysis, in order to isolate the effect of our key explanatory variable. Despite the relatively large amount of papers examining determinants of the bid premium, there are relatively few studies analyzing country- and region specific factors. Rossi and Volpin (2004) find that the bid premiums is higher in countries with higher shareholder protection, while Hope et al. (2010) find that the bid premiums in transactions with bidding firms from developing countries, where the target is located in a developed country, are higher than the bid premium in outbound M&As from developed countries. No previous studies in the field of Finance studying the Chinese bid premium have been found. In the field of International Business Management, extensive research on Chinese outbound investments has been carried out. And numerous of researchers points at different reasons to why these investments must be analyzed differently from investments from other countries. Buckley et al. (2007) points at three specific reasons, which are capital market imperfections, the special

ownership advantages of Chinese multinational corporations and institutional factor. Finally, Ma and Andrews-Speed (2006) specifically discuss the reasons why Chinese national oil companies "overbid", unfortunately due to the design of international business research; it is not apparent how these findings are proven.

3. Hypothesis

In the following section we make an attempt demonstrate the reasoning behind our research problem: whether Chinese bidders pay a higher premium when acquiring assets outside of China compared to other bidders. We do so by categorizing and summarizing the arguments based on three main factors in line with classical valuation theory; synergies, cost of capital and the computation of free cash flow. These arguments are based on the assumption that the Chinese domestic market is not at all times efficient in line with classical financial theories (Buckley et al. 2007, McKinsey 2008, Deloitte 2009 and Warren et al. 2004).

3.1 Chinese overbidding

As described introductory, we have not been able to find any academic research investigating our main hypothesis; *the bid premiums in outbound Chinese M&A are higher than for deals in general.* However, a McKinsey report from 2008 goes far in claiming that this is the fact. It states that Chinese firms do "overpay" in international deals. Unfortunately, the financial analyses behind their conclusions are not clear.

This report (McKinsey 2008) claims that;

> "They (Chinese firms) have underwhelmed the market by the standard of value creation measured thorough share price movement around the time of announcement, namely, the deal value added, and proportion overpaid. Although, drawn from a relatively small sample, our analysis suggests that Chinese acquirers tend to overpay in a little more than half of all deals and that the capital markets on average discount the value of the combined entities." (McKinsey 2008, 11)

The report further argues that deals of Chinese bidder firms between 1995 and 2007 performed less favorably compared to deals from other countries (McKinsey 2008)

A Deloitte publication (2009) that also examines Chinese outflow M&A deals, have findings which we find connectable to the McKinsey report. Head of Deloitte China M&A Services & Global Chinese Services Group Co-Chairman,

Lawrence Chia, argues that state-sanctioned acquisitions are an important driver for Chinese outflow M&As; "with Chinese state-owned enterprises being offered large loans or credit agreements at preferential rates in order to purchase foreign assets" (Deloitte 2009, 7-8). Also, Chia states that Chinese state owned enterprises (SOEs) are conducting outbound M&A acquisitions as they look to grow their business in order to prevent takeover bids from lager domestic rivals. "Buying assets overseas is a sign of strength … In addition; such businesses do not have to return cash to any stakeholders and are therefore in a position to finance such acquisitions." (Deloitte 2009, 8)

The next section will provide a more detailed explanation on how these two reports are related, and might explain some of the variance in the bid premium cross section.

3.2 Summary of Chinese Bid Premium arguments

In accordance with both microeconomic and finance theory, in a common value auction, the value of the item being sold is the same for all bidders (Norli 2011). Applying discounted cash flow (DCF) valuation methods in theory, three main factors can influence the variance in bids (offer prices) in mergers and acquisitions. These are the cost of capital, potential synergies and the actual computation of free cash flow.

3.2.1 Synergies

In line with classical theories, the highest premium a value maximizing bidder would pay for a firm equals the net benefits of the synergies expected from the combined entities. The new wave of Chinese firms acquiring international brands combined with the countries low production costs and access to the world's largest market is an obvious Chinese synergy advantage (Kristoffersen and Gao 2012). Synergies are unique to the bidder, thus may very well give optimally higher bids. Geely's acquisition of Swedish Volvo, suffering from economic distress, in 2010 is a good example of this. While Kristoffersen and Gao (2012) states that the success of synergies of this combined entity remains to be confirmed, the Volvo's Annual Report 2011 does exactly so. For the full year

Volvo generated the highest net sales, the best operating income and the highest operating margin in the firm's history.

3.2.2 Cost of capital

The cost of capital (WACC) is determined by target characteristics which are the target capital structure, the cost of equity and the after-tax cost of debt. None of these variables are directly observable, and we normally employ various models, approximations and assumptions to estimate each component (Koller et. al 2010).

The literature in the Determinants of Chinese mergers and acquisitions section, mentions several factors which may affect the classical cost of capital equation, when it comes to the cost of equity and after-tax cost of debt component. These are capital market imperfections and the special ownership structures of Chinese multinational corporations. Capital market imperfections, which implies that capital is available at below market rates for a considerable period of time (Warner et al. 2004) and the Chinese ownership structure will be further described below.

Going Global strategy
The Chinese Going Global strategy was officially launched in 2000 with the intentions to promote international operations of capable Chinese firms with a view to improve resource allocation and enhancing their international competitiveness. In practice this involved making a formerly inflexible system less complex and more adaptable for Chinese firms wishing to invest internationally. Components of this strategy was among others; export tax rebates, financial assistance, foreign exchange assistance, and other incentives to Chinese enterprises wishing to invest in overseas markets (Salidjanova 2011). The changes following this initiative, made Chinese outward direct investment increased with more than 600% from 2000 till 2001 (Reve et al. 2012).

Outward FDI as Industrial Policy
The Chinese government use foreign direct investments as major part of its industrial policy. Already in 2004, guidelines were developed comprising recommended sectors and countries in which Chinese firms should invest. In particular the guidelines embraced infrastructure contributing to export of Chinese technology, and acquisitions promoting Chinese firms' international competitive

power. Outbound M&A in the energy and minerals sector was also strongly encouraged to meet the growing needs in the country (Deng 2009 and UNCTAD 2006). The Chinese Export and Credit Insurance Corporation (Sinosure) was instructed to arrange guarantee schemes within the preferred sectors, while Exim Bank (China Export and Import Bank), CDB (China Development Bank) and the other 4 major state banks was directed to follow up with financial support to Chinese firms' outbound investments (Reve et al. 2012).

Foreign currency reserves
4 out of the worlds' 10 largest investment funds are Chinese. China Investment Corporation, known from the Norwegian press as the being one of the 10 largest owners of Marine Harvest, and the 7th largest owner of DNB is one of these. SAFE Investment Company, registered in Hong Kong as a private company, is the subsidiary of Chinas State Administration for Foreign Exchange (SAFE), the governmental body responsible for managing the country's foreign currency reserves.

Due to Chinas positive trade balance over a long period of time, the nation has developed huge foreign currency reserves. Early 2011, these reserves exceeded staggering USD 3000 billion, tenfold compared to 10 years ago, which has led to China being a major creditor to the rest of the world (Chen 2012). Several of authors point at how this enables China to steadily increase investments in savings capital, at the same time as they secures both knowledge and access to natural resources and energy (Chen 2012). The acquisition of Norwegian Elkem in 2011 is an example on this.

The sections above is meant to give a relatively short introduction to how the financial premises for Chinese firms engaging in outbound M&A differ from firms in other parts of the world. Our argument is that loans at below market rate, tax rebates, and other financial support might affect the cost of equity and the after-tax cost of debt, and hence provide Chinese bidding firms with a lower cost of capital. If the cost of capital is low, it would leave the bidder to overpay. This presumption is backed by both the McKinsey report (2008) arguing that Chinese firms tend to overpay in a little more than half of all deals and that Chinese bidder firms involved in outbound M&A between 1995 and 2007 performed less

favorably compared to bidder from other countries, and Ma and Andrews-Speed (2006) when it comes to Chinese oil companies. From this we form our first hypothesis "*The bid premiums in outbound Chinese M&A are higher than for deals in general* ".

3.2.3 Computing the Free Cash Flow

All sorts of errors and differences in expectations can occur, when analyzing and trying to compute the free cash flow in order to value a potential object. In what way might this element be influenced by the acquiring nation being Chinese?

Inexperienced leaders
One main factor, highlighted in literature as well as the media is the inexperience of Chinese business leaders. While success stories of Chinese M&A definitely can be found, the Geely and Volvo case is already mentioned earlier in this section, Reve (2012) argues that about 70 percent of Chinese outbound M&A had failed by the end of 2008. A report from Asia Pacific Foundation and Canada China Council for Promotion of International Trade (2010) present what Chinese leaders themselves claims to be major challenges when investing in Canada, which are: (1) lack of expertise and knowledge concerning international management, (2) challenging to find a local partner, and (3) lack of knowledge about legal matters and market risks. "Chinese companies regularly seem to misjudge the political, labor, and environmental risks that the foreign business world presents" (McKinsey 2008, 2). Off course, this does not necessarily mean that Chinese firms do pay too much when acquiring abroad, but with such a short record in the global market, compared to the current scope of investments, this may not seem like an unrealistic possible explanation.

Professor Zhao Youzhen[2] at School of Management at Fudan University supports this argument. She highlights that inexperienced leaders may be the reason for why Chinese firms pays a higher premium, compared to other deals. Further she argues that Chinese management lack experience in the international market and that talents are few among them, as a consequent they are unfamiliar with the business practice wildly accepted in the western world. Talented management

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[2] (Seminar "Trends and Challenges of Chinese Firms' Internationalization" Nordic Center, Shanghai, 29th Oct, 2011).

can also be seen as an asset worth paying a premium for if it is possible to secure their future in the company she states (Seminar "Trends and Challenges of Chinese Firms' Internationalization" Nordic Center, Shanghai, 29th Oct, 2011).

3.3 Sub hypotheses

The main hypothesis already described is as follows; *the bid premiums in outbound Chinese M&A are higher than for deals in general.* However, there are several of related factors also interesting to analyze in order to get a deeper understanding of the core issues in our economic question. The aim of the Going Global strategy was to improve resource allocation and enhance Chinese firms' international competitiveness by tax rebates, below market rate loans and other financial support. These measures were implemented in 2000, and hence we may see a difference before and after this year. The first sub hypothesis in this thesis is therefor; *the bid premium in outbound Chinese M&A is higher after the Chinese Going Global strategy was implemented in 2000.*

The motives behind the Going Global strategy, combined with guidelines implemented in 2004 that comprises recommended sectors and countries in which Chinese firms should invest, is the background for our third hypothesis: *The bid premium in outbound Chinese M&A is higher in certain industries, such as energy and mineral sectors, and industries comprising infrastructure contributing to export of Chinese technology, compared to other deals.*

As an extension to the reasons why it might be likely to believe that the bid premium is higher in deals with a Chinese bidder, we would like to investigate the fourth and final hypothesis; *The bid premium in outbound Chinese M&A differ after the 2008 financial crisis.* A lot of articles and reports the past last years has focused on the significant decline in M&A volumes from the financial crisis in 2007 and 2008, with a particular retrenchment in cross-border activity. Despite this, Asian companies, with China as a major participant has continued to increase their presence. "Firms from the Asian region accounted for 26 percent of global M&A in 2009, up significantly from 20 percent in 2007 and 2008, not to mention 10 percent in 2000 and 2001" (McKinsey 2010, 18).

4. Methodology

The following section will first specify the econometric models used in this study. Secondly, we describe our sample and the criteria followed in order to ensure the quality of the data.

4.1 Methodology

4.1.1 Multiple regression model

In order to examine the relationship between the dependent and independent variables, we run the following OLS[3] regression;

Log(Bid Premium) = α + β_1 (China dummy variable) + β_n (Control variables) + ε

For a multiple regression, a dependent variable and a number of independent variables are needed. In this study the independent variables are the key explanatory variable, acquirer country and control variables used to isolate the effect on the bid premium of the acquirer being Chinese. This methodology is consistent with previous research on the bid premium presented earlier in this paper.

4.1.2 The dependent variable

The dependent variable in the study is the bid premium. The premium is the bid price as a percentage of the closing price four weeks before announcement of the deal, as defined in Thomson SDC.

4.1.3 The independent variables

Key explanatory variable
The key explanatory variable will be the acquirer's country. A dummy variable is applied in order to identify whether the acquirer country is Chinese and involved in an outbound transaction.

Testing the sub-hypothesis related to time period and industry we multiply the dummy variables in question, and by this create the desired variables; Hypothesis 2; Chinese bidder*Transaction after 2000, Hypothesis 3; Chinese bidder*Industry

SIC1000-1999 and Chinese bidder*Transaction after 2000* Industry SIC1000-1999 and finally for the last hypothesis, Chinese bidder*Transaction after 2008.

Control variables

Control variables are included to better construct a model with high explanatory power and significant variables. As carefully illustrated in the theory section, they have been found significant in previous research when testing the bid premium. By including these control variables the model becomes more robust, as the dependent variable, the bid premium is affected by several factors. The control variables are used to keep these factors constant and hence the relationship between the acquirer being Chinese and the bid premium can be isolated. In addition to previous studies, data availability and missing data in the datasets have had a large impact on the control variables chosen.

Table 4.1 Overview of Control variables

This table presents the control variables used in order to isolate the effect of the acquirer being Chinese. The table also includes information about how many of the Chinese observations in the set (in total 81) that have this variable.

Quantitative variables	Definition	Status Chinese outbound deals
1) Target		
Target size	Enterprise value at Announcement Date: Is calculated by multiplying the number of target actual shares outstanding from the most recent source available by the offer price and then by adding the cost to acquire convertible securities, plus short-term debt, straight debt, and preferred equity minus cash and marketable securities. Defined in Thomson SDC.	79/81
Market value/Book value	Target market value / Target book value as defined in Thomson SDC.	30/81 Too much missing data, variable not included as control variable
Leverage	Target Long term debt / Shareholders equity as defined in Thomson SDC.	45/81 Too much missing data, variable not included as control variable
2) Bidder		
Acquirer Termination Fee	Indicator variable that takes the value of 1 if the acquirer pay a fee to target if the deal is not completed.	81/81
Percentage held at Announcement	Percentage of common, or common equivalent, shares outstanding held by the acquirer as of the	26/81 Too much missing

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[3] Ordinary Least Square

	announcement date as defined in Thomson SDC.	data, variable not included as control variable
3) Deal characteristics		
Cash payment	Indicator variable that takes on a value of 1 if the bid is a cash bid	65/81
% Shares owned after Transaction	Percent of shares owned after the transaction	78/81
% Shares Sought	Percentage of outstanding shares sought by the acquirer	81/81
Transaction Value	Log of value of transaction, as defined in Thomson SDC	81/81
LBO	Leveraged Buyout. Thomson SDC includes transaction in which management forms a part of the investor group (MBO) in this definition, as well as transactions that are identifies as an LBO in the financial press if majority interest of the company is acquired	81/81

4.2 Empirical data

4.2.1 Sources and Data collection

In order to execute this study, data from three different sources, Thomson Financial SDC, mergermarket and Zephyr, has been collected. There are several reasons for this. Almost all previous research referred to in the bid premium theory section has employed data from Thomson Financial SDC. But due to the limited amount of Chinese outbound deals, it was natural to also explore other options, in order for our analysis to be as accurate and valid as possible. Zephyr, the library database showed to have a very limited number of observations. The third source, mergermarkets, came to our attention through a Deloitte report (2009), which referred to a higher amount of deals than the initial datasets contained, and interesting result when it comes to overbidding in Chinese outbound M&A deals. Finally, the possibilities of comparing results from three different sources, is also a major reason for extracting data from these databases, and hence strengthen a possible acceptance or rejection of the hypothesis. Because the definitions of main measures vary in the different datasets and due to the degree of incompleteness data observations (Zephyr and mergermarkets) when it comes to the control variables, the datasets cannot be added together and the results cannot be compared.

That being said, the main sample examined in the analysis is collected from Thomson Financial SCD. The reasons for choosing this dataset is it's superiority

when it comes to the number of observations (including Chinese observations), the time horizon, it's completeness when it comes to the control variables, and finally the possibilities of comparing the results to previous research.

4.2.2 The Sample

Choice of the time period and geographic region
The choice of time period was decided by the data availability. The time period stretching from the early 1986 to today and hence covers several of crises, i.a. in recent time the financial crisis (2007-2009) and the ongoing financial cries part two.

This thesis focuses on Chinese cross-border M&A activity. Hence, the geographic requirement is that the acquirer should be of a Chinese, Hong Kong or Taiwan nationality and the target placed outside the region of China, Hong Kong or Taiwan. These three countries are all under Chinese authority, hence has natural arguments for why they should be matched. This has been done in other research (Deloitte 2009), and finally, it was necessary in order to obtain enough data. Throughout this thesis bidders from these three nationalities, involved in acquisitions outside this region will be referred to as "Chinese bidders".

Industry
A sub hypothesis is that Chinese acquiring firms are willing to pay a higher premium for targets in some industries compared to others. This is connected with the facts presented in the hypothesis chapter regarding the Chinese Going Global strategy and the 2004 guidelines by the Chinese government encouraging and providing i.a. cheaper loans to Chinese firms engaging in M&A in certain industries. These are natural resources and investments in infrastructure (Reve et al. 2012, McKinsey 2008, and others). To isolate relevant companies and deals, different branch codes and classifications can be used. For this purpose different branch of industries has been defined using US SIC codes. The group which matches what we aim at analyzing in accordance with hypothesis 3 is SIC group 1000-1999, Mining and construction, which comprises metal mining, crude petroleum and natural gas, drilling oil and gas wells, mining and quarrying of nonmetallic minerals, and heavy construction (www.siccode.com).

Table 4.2 SIC Code Category and amount of Chinese outbound deals

This table presents the number of Chinese outbound deals in some of the main SIC code groups, defined by Thomson Financial SDC. This overview is relevant for hypothesis 3, investigating whether the premium is higher in deals in certain industries. The overview is based on our sample of 12 700 takeover transactions, between 1986 and 2011.

SIC Code	Category	Chinese outbound deals
1000-1999	Mining and construction	24
2000-3999	Manufacturing	28
6000-6999	Finance, insurance, and real estate	11
7000-7999	Services	7

Sample formation

In order to extract an accurate measure for bid premium only public companies are included in our analysis. We identified the takeover transactions through the Thomson Financial SDC database, and target successful transactions that occurred between March 1, 1986 and December 31, 2011. We initially observed 20,091 deals.

Table 4.3 Sample formation

This table presents the transactions that are eliminated because they do not fulfill the criteria's needed for a complete data set, in line with the criteria formulated above

Criteria/deleted deals	Total deals	Chinese outbound deals
Total amount of deals from start	20 091	170
Deleted negative bid premium	3008	40
Deleted non-completed deals	4282	47
Deleted deals <50 %	101	2
Total	**12 700**	**81**

Following Rolls arguments (applied in Officer 2003, Lemmon and Bates 2003, Hope et al. 2010, and others) the second requirement is that the bid premium is greater than zero. This restriction follows extant research and is employed to ensure economic reasonableness of the bid premium data (Hope et al. 2010). Specifically, Officer (2003) criticizes the measure of bid premium using SDC price data on grounds that has a tendency of reporting outliers below zero (an economically reasonable lower bound). Bids below the current market price is abandoned in literature, since rational target shareholder would turn down offers to buy their shares below what is expected in an arm's length transaction on the stock exchange (Roll 1986). Following this argument, we eliminated 3008

transactions in total, of which 40 Chinese outbound deals were of non-positive character and respectively 4,282 deals in general and 47 Chinese that were not completed.

A final requirement is that the acquiring firm stake is exceeding 50 percent after the acquisition. The reason for this criterion is our desire to analyze strategic and long term acquisitions, which might not be the case when the deal is of a smaller size, which implies a financial character and a shorter term horizon. Previous research have fund that acquiring a majority stake (over 50 percent) have a significant effect on the size of the bid premium compared to acquire smaller stakes (Walking & Edmister 1985). This lead us to eliminate 101 common deals and two Chinese outbound deals, as illustrated in table 4.3.

After this elimination, we obtained a final sample of 12,700 transactions containing 81 Chinese outbound transactions.

Revision of the data
The data has been reviewed manually and data showing obvious errors have been eliminated. As noted by Officer (2003), Bates and Lemmon (2003) and others, the premiums computed using SDC data are very noisy and includes many large outliers. We address this criticism by using premiums greater than zero, by deleting obvious errors, and winsorizing extreme observations. Following Officer, the bid premium measure is equal to our primary measure when its value is greater than zero and less than the interval of the upper fence, defined as $Q2+3*IQR$[4]. This outlier detection criterion, beyond an outer fence which is considered extreme outliers, is included in order to get accurate estimators. While the data with obvious errors was deleted, 417 in total and 7 Chinese extreme values were replaced with the closest non extreme value, in line with the Winsorize method (Wilcox 2010, 152). The upper fence corresponded to a bid premium of 155.92 %. The aim of this method is to keep as much information as possible.

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[4] $Q2+3*IQR$ = Quartile 2 (the median of the dataset) + 3* the interquartile range, which is the difference between Q3 and Q1 (quartile 3- quartile 1).

4.3 Modeling difficulties

Missing values
The datasets had problems with missing values. As illustrated in table 4.1, due to the limited number of Chinese outbound deals, we have had to elimination a lot of control variables which we initially wished to examine in order not to reduce the sample size when running the regression.

The tradeoff between number of observations and control variables has been carefully carried out throughout the analysis. One by one control variable is added in order to ensure that the reduced number of observations does not affect the outcome in other variables. Also, it is ensured that the limited amount of deals with Chinese bidders is not at all affected by missing values in the control variables. This applies to the regression analysis in all hypotheses. When constructing the model we applied the general-to-specific methodology (Brooks 2008). It is conducted as follows: first a large model with lots of variables on the right hand side is assembled known as a generalized unrestricted model. The next step is to reparameterise[5] the model by knocking out very insignificant repressors. If the assumption of classical linear regression model (CLRM) is held we have a statistically adequate empirical model that can be used to test underlying financial theories (Brooks 2008).

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[5] The process of deciding and defining the parameters necessary for a complete or relevant specification of a model.

5. Results

In this section the statistical results and implementation of the study will be described.

5.1 Statistical description of the premium

Figure 5.1 presents the average premium for each year of the study period, and illustrates how it varies over time. The average premium peeks in 1988 and 1990 before it takes a few dips and has another peak in 2008.

Figure 5.1 Average bid premium
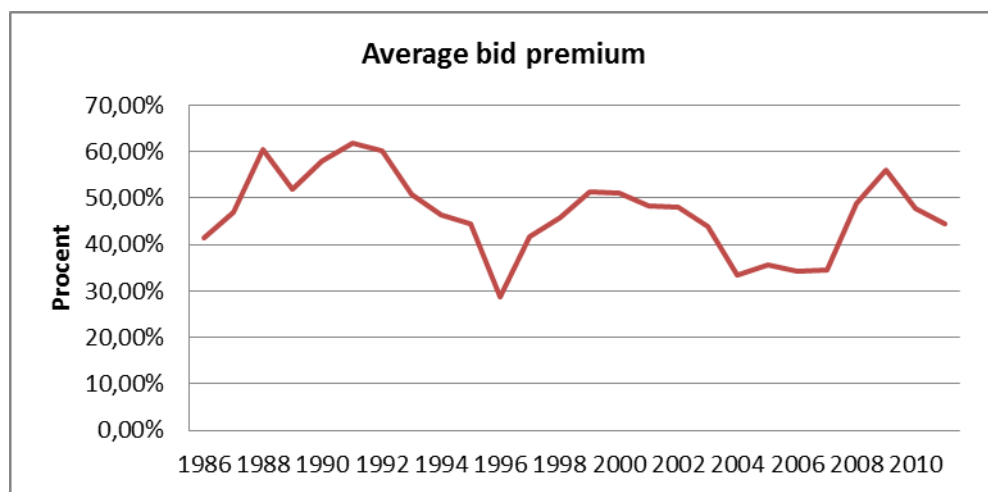
Hypothesis 1 – Chinese bids in general

The dependent variable in our model, namely the premium paid by the bidder, varies considerably. Table 5.2 contains a statistical description on the premiums, according to our hypotheses. Panel A shows that the average premium in the full dataset is 45.5 percent, the standard deviation is 36.1 and the median is 36.0 percent. The average premium offered by Chinese bidders is a little higher at 47.1 percent, while the median is quite a lot lower at 29.4 percent. These results does not give us any indications that we will be able to reject the null hypothesis, stating that *the bid premiums in outbound Chinese M&A are not higher than for deals in general.*

Table 5.2 Descriptive of the determinant variables

This table presents the descriptive statistics on the dependent variable, the bid premium, namely the mean, standard deviation, median, minimum and maximum. It illustrates the different values, when splitting up the main sample in several of subsamples, in order to analyze the spreads in accordance with our hypothesis. H1 denote hypothesis 1, H2 is Hypothesis 2, etc.. All figures in the tables are percentages.

Dependent variable Bid premium 4 weeks	Mean	Standard deviation	Median	Min	Max	Number of obs.	Premium spread
PANEL A							
H1: All deals SCD	45.517	36.100	36.000	0.030	155.920	12700	
H1: Chinese Deals	47.134	44.827	29.410	0.840	155.920	81	1.617
PANEL B							
H2: Before 2001 All deals	49.019	35.714	40.360	0.080	155.920	6069	
H2: Before 2001 Chinese deals	40.170	38.809	25.225	7.140	155.920	18	-8.849
H2: After 2001 All deals	42.312	36.156	32.210	0.030	155.920	6631	
H2: After 2001 Chinese deals	49.124	46.495	32.870	0.840	155.920	63	6.812
PANEL C							
H3: SIC 1000-1999 All deals	45.963	38.393	34.690	0.230	155.920	1236	
H3: SIC 1000-1999 Chinese deals	58.178	42.812	43.020	5.910	155.920	24	12.215
PANEL D							
H4: Before 2008 All deals	44.737	35.395	35.480	0.030	155.920	10530	
H4: Before 2008 Chinese deals	33.682	36.223	22.160	0.840	155.920	48	-11.055
H4: After 2008 All deals	49.304	39.130	39.005	0.070	155.920	2170	
H4: After 2008 Chinese deals	66.700	49.298	54.840	5.910	155.920	33	17.396

Hypothesis 2 – Going Global strategy

The Going global strategy was implemented in 2000, and involved a wide-range of regulatory and financial changes in the support system intended to promote outbound investments by Chinese firms. In the hypothesis part, we form the null hypothesis stating that *the bid premium in outbound Chinese M&A is not higher after the Chinese Going Global strategy was implemented in 2000.* This might to some extent be reflected in the descriptive statistics, Table 5.2 Panel B. The average bid premium offered by bidders in general is 49.0 percent before 2001 and 42.3 percent after 2001 and respectively 40.2 percent and 49.1 percent among the Chinese bidders. This gives a negative spread of 8.8 before 2001 and a positive spread, meaning that Chinese bidders on average pay 6.8 percent more than other bidders, after 2001.

Hypothesis 3 – Industry

The industry group with SIC-codes 1000-1999 corresponds to Mining, such as; metal mining, coal mining, oil and gas extraction, and Construction, which include heavy constructions and special trade contractors. These sectors are well in accordance with the industries in our third hypothesis, *stating that the bid premiums in outbound Chinese M&S are higher in certain industries such as energy and mineral sectors and industries comprising infrastructure which contributes to export of Chinese technology, compared to in other deals.*

Table 5.2, Panel C, presents the descriptive of a sub-sample within this particular SIC group, 1000-1999. The average target shareholder is offered a 46.0 percent takeover premium by the bidder, while the average premium offered by Chinese bidders is 58.2 percent. This is a spread of almost 12.2 percent between the two groups. The median is 34.7 percent for the general group, which is rather close to the median for the full dataset, while the median for the Chinese bidders is 43.0 percent, yielding a spread of 8.3 percent.

Hypothesis 4 – Financial crisis

Table 5.2, Panel D, presents the descriptive of the premiums in sub samples before and after the financial crisis. In the hypotheses part, we discuss how the financial crisis has led to a decline in cross border M&A, while Asian companies, with China as a major participant has continued to increase their presence. From

this we formulate a null hypothesis stating that *the bid premium in outbound Chinese M&A does not differ after the 2008 financial crisis,* and we argue that this might be seen in the descriptive statistics. Transaction with Chinese bidder involved in outbound M&A corresponds to 1.2 percent of all the deals in the sub sample after 2008, while it is only 0.5 percent of the sample before 2008 (57/10541 before 2008 and 26/2178 after 2008). And also, while there is a negative spread at 11.1 percent when comparing the average premium in general to the Chinese premium before 2008, the spread after 2008 is at 17.4 percent. This development is definitely verified by looking at the medians.

5.2 Statistical description of the explanatory variables

Table 5.3 contains a statistical description of the explanatory variables used as control variables in the model. Several of variables have large standard deviations. We consequently include the median to ensure that the interpretations based on the mean are not biased.

Table 5.3 Descriptive statistics of the independent variables

This table presents the descriptive statistics of the independent variable, namely the mean, standard deviation, median, minimum and maximum. The sample is calculated based on our sample of 12 700 takeover transactions between 1986 and 2011.

Independent variable	Mean	Standard deviation	Median	Minimum	Maximum
1) Target					
Target size	2408.639	20247.830	214.0730	-184.6810	1221009.000
2) Bidder					
Acquirer Termination Fee	0.104	0.305	0	0	1
3) Deal characteristics					
Cash payment	0.496	0.500	0	0	1
% Shares owned after	95.124	12.518	100	50.00	100.000
% Shares Sought	91.306	18.565	100.000	0.300	100.000
Transaction Value (mil$)	1026.522	4592.420	136.127	0.019	202785.1
LBO	0.086	0.280	0	0	1

5.3 Regression analysis

The following sections will further investigate the relationship between the bid premium and the bidder being Chinese. Using OLS regression, we now continue the analysis by controlling for other variables previously found to affect the premium, in order to isolate the effect of the bidder being Chinese.

Similar to the descriptive chapter, we first investigate the main hypothesis, whether or not Chinese bidders in general involved in outbound M&A pays a premium compared to bidders from other countries, before we continue to investigate the three sub hypotheses.

Control variables

The results of the regressions are presented in Table 5.4. Some of the results are consistent with the findings in the literature section. The positive and significant % Shares Sought is in accordance with among others Billett and Ryngaert's (1997) and Hope, Thomas & Vyas's (2010) research, and the positive Cash payment variable coefficient is in line with among others Betton, Eckbo and Thorburn's (2008b) studies.

In addition to the variables presented above, also Log(transaction value), the LBO variable and both Time(2001)- and Time(2008)-dummy is statistical significant at a 1 % level.

In this thesis the adjusted R^2 has been used as a measurement, since the standard R^2 is not adjusted for the number of parameters in the model. R^2 does almost always increase and nearly never decrease when adding a parameter. This implies that R^2 gives an exceptionally optimistic picture of the regression models fit to the reality (Gujarati, 2003).

Table 5.4 Determinants of the takeover premium

This table presents the results of five OLS regression for the main sample of individual deals, 12.700 deals, between 1986 and 2011. The dependent variable is the natural logarithm of the bid premium, or the bid price as a percentage of the closing price of the target four weeks before the announcement. H1 denote hypothesis 1, H2 is Hypothesis 2, etc.. Note that the figures in parenthesis are standard errors.

Significant levels * = 1%, ** = 5%, *** = 10%

	PANEL A H1 - All deals	PANEL B H2 - Go global	PANEL C H3 - Industry	PANEL D H2&3 - Combined	PANEL E H4 - Fin. crisis
Key explanatory variables:					
Chinese bidder	-0.092 (0.139)				
Chinese bidder + time dummy(2001)		-0.092 (0.139)			
Chinese bidder + industry dummy(SIC 1000-1999)			0.284* (0.093)		
Chinese bidder + industry (SIC 1000) + time dummy(2001)				0.284* (0.093)	
Chinese bidder + time dummy(2008)					0.408** (0.171)
Control variables:					
Target size	-3.66E-07 (4.57E-07)	-3.66E-07 (4.57E-07)	-3.63E-07 (4.57E-07)	-3.63E-07 (4.57E-07)	-3.63E-07 (4.57E-07)
Termination fee	-0.046 (0.032)	-0.046 (0.032)	-0.047 (0.032)	-0.047 (0.032)	-0.047 (0.032)
Cash payment	0.129* (0.021)	0.129* (0.020)	0.129* (0.020)	0.127* (0.021)	0.128* (0.020)
% Shares owned after trans.	0.387* (0.087)	0.387* (0.087)	0.387* (0.087)	0.389* (0.087)	0.389* (0.087)
% Shares Sought	0.270* (0.044)	0.270* (0.044)	0.270* (0.044)	0.271* (0.045)	0.271* (0.045)
Log (Transaction value)	-0.031* (0.005)	-0.031* (0.005)	-0.031* (0.005)	-0.031* (0.005)	-0.031* (0.005)
LBO	-0.093* (0.032)	-0.093* (0.032)	-0.092* (0.032)	-0.092* (0.032)	-0.092* (0.032)
Industry dummy (SIC 1000-1999)	0.005 (0.031)	0.005 (0.031)	0.002 (0.031)	0.002 (0.031)	0.0002 (0.030)

Time dummy 2001	-0.300* (0.022)	-0.300* (0.022)	-0.300* (0.022)	-0.266* (0.022)	-0.265* (0.021
Time dummy 2008	0.274* (0.030)	0.274* (0.030)	0.272* (0.030)	0.272* (0.030)	0.270* (0.030)
Adjusted R^2	0.048	0.048	0.048	0.048	0.048

Hypothesis 1 – Chinese bids in general

The results in table 5.4 Panel A, corresponds to our first hypothesis, where we simply investigate whether an indicator variable that takes the value of 1 if the bidder is Chinese, has an impact on the bid premium. This variable, the Chinese bidder dummy coefficient is not significant. This means that we cannot reject the null hypothesis, and hence do not find any evidence that Chinese bidders involved in outbound M&A do pay a higher premium compared to other bidders.

Hypothesis 2 – Going Global strategy

The results from the regression testing the Going Global strategy hypothesis, is found in Table 5.4 Panel B. The key explanatory variable in this regression is a dummy variable that takes the value of 1 if the bidder is Chinese and the bid is carried out after year 2001. This variable is not significant, and does not make us able to reject our null hypothesis. Again, we do not find any evidence that allows us to say that Chinese outbound deals that are carried out after 2001 have a higher premium compared to other deals in general.

Hypothesis 3 – Industry

Table 5.4, Panel C presents the results of the regression model corresponding to hypothesis 3, stating that *the bid premium in outbound Chinese M&A is higher in certain industries, compared to the premium in other deals.* An indicator variable with the value 1 if the bidder is Chinese and target is in SIC group 1000 -1999 is used as key independent variable. This dummy variable is positive and significant at 1% level. A beta coefficient of 0.284 corresponds to a 32.8 percent[6] increase in

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[6] A beta coefficient of 0.284 is the ratio of the geometric mean for Chinese bidder group to the geometric mean for all other bidders. We can say that the expected percent increase in geometric mean from all other bidder group is about 32.8% holding the other variables constant, since exp(0.284) = 1.32843293.

the takeover premium if the acquire are of Chinese nationality and the target is in industry group 1000-1999. This means that we can reject the null hypothesis.

Another interesting finding important to point out is that the dummy variable (SIC 1000-1999) representing all deals within this industry are not significant at all, backing up our presumptions that this is not a common feature for this SIC-group in general.

In order to verify this result we have run regressions on the three additional SIC-groups which contained an adequate number of Chinese outbound deals. These groups are presented in Table 4.2. However, none of the additional groups provided us with results similar to SIC- group 1000-1999; positive and significant coefficients. These regression results can be found in Appendix A.

A regression that combines hypothesis 2 and 3 is also carried out, presented in Panel D. The key independent variable in this regression is an indicator variable that has the value of 1 if all three criteria are fulfilled; the bidder is Chinese, the target is in SIC group 1000-1999 and the transaction happened after 2000. Unfortunately, only one transaction is excluded in this new variable compared to the independent variable in Panel C. (Only one of the transactions with Chinese bidder acquiring a target abroad, within SIC group 1000-1999, is carried out before 2001). This gives us a positive and significant coefficient, with the exact same value as this key independent variable 0.284 in Panel D. We are therefore, because of inadequate number of Chinese deals in SIC group 1000-1999 before 2001, unable to test whether the Going Global strategy affects these industries (SIC 1000-1999) in particular.

Hypothesis 4 – Financial crisis

Contrary to hypothesis 2, the results in Table 5.4 Panel E provide us with a positive coefficient which is significant at 5% level. The combined dummy with value 1 if the bidder is Chinese and the transaction is carried out in 2008 and after 2008 has a coefficient of 0.408, which corresponds to a 50.4 percent[7] increase in the takeover premium if the acquirer is of Chinese nationality and the transaction

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[7] Since exp(0.408) = 1.80380716.

is carried out during or after 2008. This means that we can reject the null hypothesis, saying that *the bid premium in outbound Chinese M&A does not differ after the 2008 financial crisis.*

5.5 Statistical remarks

The models have been tested for heteroscedasticity, autocorrelation, multicollinearity and normality. We have problems with heteroscedasticity and autocorrelation in the data sets for all the models, which results in our coefficients estimates still being unbiased, but they are inefficient, i.e. they are not BLUE (Best linear unbiased estimators). (Brooks 2008). All results presented in table 5.4 have been corrected with the Newey-West remedy. The Newey-West remedy is a variance-covariance estimator consistent in the presence of both heteroscedasticity and autocorrelation (Brooks 2008). Further tests applied to the model do not provide any signs of multicollinearity. We do have issues regarding non-normality in the model.

When applying the F-test for multiple regressions all the coefficients in the models are significant different from zero and we can reject the null hypothesis for all of them. In other words the models have explanatory power with respect to the bid premium. The independent variables explain some of the effect on the bid premium. All the models are significant.

6. Conclusion

It is commonly assumed that that the unique Chinese context due to the country's spectacular economic growth and communist state control provides Chinese firms with different premises than firms in other parts of the world. In academic papers in the field of International Business Management, non-academic publications and among people in the world of finance and other industries, it is argued that this affects the bid premium and that Chinese firms overpay when acquiring firms in other counties. While there exist extensive research about the determinants of the acquisition premium, few papers are written aiming to examine country specific factors. No previous studies in the field of Finance is found investigating the relationship between the bid premium and the acquirer firm being Chinese.

In this thesis report we do find evidence that when Chinese bidders are involved in outbound mergers and acquisitions of targets in the industry groups that comprise Mining; metal mining, coal mining, oil and gas extraction, and Construction; heavy constructions and special trade contractors, they do pay a higher premium compared to other deals. Our results show that Chinese bidders involved in outbound M&A in this particular industry group have a 32.8 percent increase in the takeover premium, compared to all other bidders. These industries matches the industries in which Chinese government has created incentives for Chinese firm to acquire in overseas markets, through the Going Global strategy and 2004 guidelines, and are also essential to secure further growth in the Chinese economy.

We also find evidence supporting our last sub hypothesis, and have reasons to believe that China bidders pay a higher premium compared to other bidders based on their favorable position in the world economy after the financial crisis in 2007/2008. The years after the financial crises has led to a decline in M&A volumes, with a particular retrenchment in cross-border activity, Asian companies with China as a major participant has continued to increase their presence. How this is directly linked to the bid premium might have different explanations, however it is a fact that while most European countries and companies has experienced a recession, the Chinese economy has grown (until recently) at a two digit speed. Our results are positive and significant, with a beta coefficient

corresponding to a 50.4 percent increase in the takeover premium, if the acquirer firms are Chinese and the transaction is carried out in 2008 and after.

We do not find any evidence suggesting that Chinese firms in general pay a higher premium, compared to other bidders when involved in outbound M&A transactions. This is apparent from both the descriptive data and regression analysis. However, due to data availability and the definition of the bid premium, M&A of private character are not included in the analysis. If we were able to include private deals we might have obtained different results.

All results and analysis must off course be seen in light of several weaknesses when it comes to data availability; the fact that we only analyze public companies, the reporting procedures within China that has been weak, but are improving, the phenomenon of round-tripping, missing data in control variables, and the few Chinese observations in the datasets of the sub-hypothesis are examples backing this.

For future research on the topic we suggest including the private transactions in order to obtain a larger sample number and even more interesting data.

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APPENDIX A

Results from industry groups

This table presents the results of three OLS regression for the remaining three industry groups SIC 2000 – 3999, 6000 – 6999 and 7000 – 7999. Main sample of individual deals, 12.700 deals, the Chinese outbound deals within each group are 28, 11 and 7 respectively and time period stretches between 1986 and 2011. The dependent variable is the natural logarithm of the bid premium, or the bid price as a percentage of the closing price of the target four weeks before the announcement. Note that the figures in parenthesis are standard errors. Significant levels * = 1%, ** = 5%, *** = 10%

	Industry Manufacturing SIC 2000-3999	Industry Finance, insurance and real estate SIC 6000-6999	Industry Services SIC 7000-7999
Chinese bidder + industry dummy(SIC 2000 - 3999)	-0.060 (0.213)		
Chinese bidder + industry dummy(SIC 6000 - 6999)		-0.551 (0.338)	
Chinese bidder + industry dummy(SIC 7000 - 7999)			-0.617*** (0.372)
Target size	-2.97E-07 (4.29E-07)	4.48E-08 (4.39E-07)	-3.11E-07 (4.29E-07)
Termination fee	-0.0456 (0.029)	-0.056** (0.029)	-0.051*** (0.029)
Cash payment	0.121* (0.019)	0.113* (0.019)	0.123* (0.019)
% Shares owned after trans.	0.394* (0.089)	0.391* (0.090)	0.385* (0.089)
% Shares Sought	0.272* (0.047)	0.277* (0.047)	0.266* (0.046)
Log (Transaction value)	-0.032* (0.005)	-0.033* (0.005)	-0.031* (0.005)
LBO	-0.095* (0.027)	-0.113* (0.027)	-0.095* (0.027)
Industry dummy of respective industry	0.068* (0.020)	-0.175* (0.025)	0.126* (0.023)
Time 2001	-0.295* (0.020)	-0.303* (0.020)	-0.308* (0.020)

Time 2008	0.277*	0.260*	0.274*
	(0.028)	(0.027)	(0.027)
Adjusted R^2	0.049	0.053	0.050

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Preliminary Thesis Report

Examining the Bid Premium in Chinese outbound M&As

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Date of Submission:
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Master of Science in Business & Economics - Finance

Content

Abstract

In this preliminary thesis report we will introduce the ongoing work with our Master Thesis in the field Finance. The main question we have chosen to analyze is whether Chinese firms pay a higher premium (relative to companies from other countries) when they acquire assets abroad. The background for why we find it interesting is the ongoing discussion worldwide regarding Chinas growing importance in the world economy and the observations of Chinas aggressive development in outbound M&A activity. This is also insinuated from people in the industry - that Chinese firms to a larger extend are pay a higher bid premium compared to others.

1   Introduction

In recent years, mergers and acquisition activity has increased rapidly around the world, and cross-border M&A activity which are increasing proportionately accounts today for almost a quarter of the global M&A volume (UNCTAD 2011). According to the United Nations Conference on Trade and Development (UNCTAD), developing countries have showed an increasing interest for cross-border M&A during the past two decades. An interesting feature of this cross border M&A wave is the series of high-profile bids by firms from China. M&A's are becoming an important way to enter foreign markets by firms from developing and transition economies (UNCTAD 2006).

China in particular has stepped onto the world stage following the turmoil that a afflicted the global financial system since the financial crisis in 2008. Nowhere is this more prevalent than in the Chinese outbound M&A market, where activity has remained solid the last years, outbound deals accounting from 10% of overall Chinese M&A activity. Some of the bids originated from China have been accompanied by a huge media frenzy, political interference, and nationalistic talk (both in the acquiring and the target country). Notable examples are the bid for Unocal by Chinese-owned CNOOC, Lenovo's acquisition of IBM's personal computer business, and the geographically nearer ones, Volvo Cars and Norwegian Elkem acquired by respectively Geely Automobile and China National Agrochemical. While these deals are examples of increasing financial power and confidence in China, it remains an open question whether these companies bid higher (relative to companies from other countries) in their quest for international expansion.

This report is organized as follows; in the next section we present the related literature with regards to previous research on bid premiums and determinants of Chinese outbound M&As. The third section constructs the hypothesis and research problem. The data and sample are described in the fourth section. The research design and methodology are presented in the fifth section, and the final section concludes.

2   Litterateur review

This literature review is divided in two main parts. First and foremost we review literature on bid premium and bid premium determinants in general. We have made an attempt to find research on topics similar to the one we will examine. In the second part we present literature on the determinants of Chinese outbound M&A´s. The purpose of the latter part is to introduce the motivations for Chinese firms to paying a premium, which again provides support for our hypothesis.

2.1 Literature on Bid Premium

Acquisitions offer a great growth opportunity for many companies. Potential economies of scale, synergies, tax savings or vertical integration make this form of growth interesting for most companies compared to organic growth that is more time consuming. Thus, in sum, research finds that bidder deal-related abnormal returns are often negative (Eckbo 2009).

Roll (1986) was the first to suggest that bidder's overconfidence or "hubris" may go a long way in explaining the surprisingly low bidder takeover gains. The relative poor bidder performance remains a pervasive and puzzeling phenomenon also today. Since part of the problem is one of properly estimating and interpreting bidder announcement returns, however, direct evidence on offer premium and bidding behavior is of key interest in this debate (Eckbo 2009).

Richard Roll (1986) formed the Hubris hypothesis, which implies that individual decision makers in bidding firms may pay a premium to acquire an asset that the market has already correctly valued for their own personal motives. Bidding firms infected by hubris simply pay too much for their targets. This phenomenon is also known as Winners curse. He points out that hubris hypotheses are consistent with strong –form market efficiency. Financial markets are assumed to be efficient in that asset prices reflect all information about individual firms. Most other explanations rely on strong-form market inefficiency, at least temporary.

Betton, Eckbo and Thorburn (2009) find that the average premium paid for American acquisitions between 1980 and 2002 equals 48 % of the market value of

the target before the initial bid, and some premiums even exceed 100%. Like Roll, they also emphasize the fact that large amounts spend when acquiring the target do not always yield the anticipated outcome because some companies tend to overvalue the potential of the transaction.

Betton, Eckbo, and Thorburn (2008b) investigate cross-sectional determinants of the bid premium by analyzing 5,921 targets between 1980 and 2002. They categorize explanatory variables into "Target characteristics", "Bidder characteristics", and "Deal characteristics" and their main findings are as follows; First, the initial and final offer premiums are higher after the 1980s, when the bidder is a public company; when the initial bid is an all-cash offer, and the higher the pre-bid target run-up. Secondly, important findings form this study are that the initial and final offer premiums are lower the greater the target total equity capitalization prior to the initial bid; when the target's book-to-market ratio (B/M) exceeds the industry median B/M; when the initial bid is a tender offer; and when the initial bidder has a positive toehold. Thirdly, the initial and final offer premiums are unaffected by the presence of a target poison pill, a garget hostility to the initial bid; the presence of multiple bidders; and whether the takeover is horizontal." (Eckbo 2008a)

Along with Eckbo, Betton and Thorburn, numerous of other researchers have contributed with takeover premium literature. Schwert (1996) presents cross-sectional regression of takeover-induced target abnormal stock return (premium) and find like Betton, Eckbo, and Thorburn (2008b), that the premium is higher for all-cash offers and for multiple bids. In his sample, the bid premium is also higher for tender offers. Officer (2003) finds that merger deals with target termination fees involve significantly higher premiums and success rates than deals without such clauses. Bates and Lemmon (2003) also investigate target fee grants and find evidence that deal premiums are higher in transactions that include such fees, after controls for various deal and target characteristics.

Levi, Li, Zhang (2008) combine data from both SDC and RiskMetrics Group and suggest that the takeover premium are influenced by the gender composition of the board. Accurately, bid premiums are lower when the CEO of

the acquiring firm is female, and the higher the target board's proportion of female directors.

When it comes to examining country- or region-specific factors and difference in the bid premium, we have not been able to find a lot of research. Rossi and Volpin (2004) study the determinants of mergers and acquisitions around the world by focusing on differences in law and regulations across countries. They find that the volume of M&A activity is significantly larger in countries with better accounting standards and shareholder protection, and also that the bid premiums is higher in countries with higher shareholder protection.

Thus, more relevant to our research question; Hope, Thomas and Vyas (2010) find that the bid premiums from developing countries, i.e. firms from developing countries involved with M&As in developed countries, are higher than the bid premium in outbound M&As from developed countries. They aim at analyzing if the higher bids by firms from developing countries are affected by national pride, and in doing so, tests their data on bid premiums between developing and developed countries using an extensive amount of control variables.

2.2 Determinants of Chinese outward FDI

Thus we have not been able to find prior academic research that examines the bid premium in Chinese outbound M&A deals, Chinese "overbidding" has been discussed in different other publications and the rationale behind the phenomenon is widely analyzed in the international management field.

A McKinsey report from 2008 claims that "They (Chinese firms) have underwhelmed the market by the standard of value creation measured thorough share price movement around the time of announcement, namely, the deal value added, and proportion overpaid. Although, drawn from a relatively small sample, our analysis suggests that Chinese acquirers tend to overpay in a little more than half of all deals and that the capital markets on average discount the value of the combined entities." (McKinsey 2008, 11) They further argue that deals of Chinese firms between 1995-2007 performed less favorably than those of Western did. A Deloitte publication, also examining the Chinese outflow M&A deals suggest the

same. Head of Deloitte China M&A Services & Global Chinese Services Group Co-Chairman, Lawrence Chia, argues that state-sanctioned acquisitions are an important driver for Chinese outflow M&As; "with Chinese state-owned enterprises being offered large loans or credit agreements at preferential rates in order to purchase foreign assets" (Deloitte 2009, 7-8). At the same time, Chia also notes that Chinese SOEs are conducting outbound M&A acquisitions as they look to grow their business in order to prevent takeover bids from lager domestic rivals. "Buying assets overseas is a sign of strength", he says. "In addition, such businesses do not have to return cash to any stakeholders and are therefore in a position to finance such acquisitions." (Deloitte 2009, 8)

A growing number of articles have been published the last years which looks at the motivations of Chinese firms to expand internationally. Most researcher (Buckley, 2007; Morck, 2007; Poncet, 2007) agree that classical motivations play the key role: Chinese firms are to various extents market-seeking, resource-seeking, and strategic asset-seeking. However, these characteristics, originally developed in a Western context and for Western companies, do not completely reveal all motivations of Chinese foreign direct investments (Gugler and Boie 2008).

Buckley (2008) argue that there are three potential arguments to why FDI from emerging economies and China in particular require a different approach to theory, then general internalization theory. These are; capital market imperfections, the special ownership advantages of Chinese MNEs and institutional factors. All three of these are in our opinion to some extent important in order to support our hypothesis; that Chinese M&A's are carried out with a bid premium.

Capital market imperfections, which may mean that capital is available at below market rates for a considerable period of time, arise in China for a number of particular inter-related imperfections; Warner et al. (2004) and others suggests that state-owned (and state-associated) firms may have capital made available to them at below market rates. He also points at the fact that inefficient banking systems may make soft loans to potential outward investors. Third, conglomerate firms may operate an internal inefficient capital market that subsidizes outflow

M&A's (Liu, 2006), and finally, family-owned firms may have access to cheap capital from family members. Buckley et al. (2007) argue that there are good reasons to believe that all four of these imperfections exist in China. State-sponsored soft budget constraints make acquisitions by Chinese firms a normal mode of entering and penetrating a host economy.

Ma and Andrews-Speed (2006) specifically discuss the reasons why Chinese national oil companies "overbid", which is here defined as paying more for the asset than prevailing market price. They lists reasons in addition to capital market imperfection as already mentioned above, such as: their commercial world view, their strategy, their inexperience and the role of the government. Close support from the Chinese government may indeed lower the political risk in some countries, which combined with access to loans from state-owned commercial banks will result in China's national oil companies having a lower cost of capital than international oil companies. The authors addresses the question on which cases of "overbidding" are the result of deliberate strategy and which are the result of inexperience, as one of their major questions.

3 Hypothesis and Research question

3.1 Hypotesis

As can be seen from the literature review, the last decade has provided us with an extensive amount of research on both takeover premiums and its determinants, and on determinants of Chinese outflow M&As. Several of publications, and articles from the international management field, claim and argue why Chinese firms tend to "overbid", relative to companies from other countries, when involved in international contests. We have however not found any academic research proving this fact. Hence, our hypothesis is as follows;

H_0 : The bid premiums in outbound Chinese M&A are higher than for deals in general.

3.2 Research question

Does Chinese firms on average bid higher to acquire assets outside of China, compared to bids in general?

3.3 Definition of Bid Premium

Prior to the availability of offer prices in databases such as Thomson's SDC, the empirical takeover literature conventionally used target cumulative abnormal stock returns around takeover bids as a proxy for bid premiums. This proxy is problematic as target abnormal stock returns reflect not only the offer price but also the probability of competition and bid failure at the initial offer date. The reducing effect of the residual uncertainty about bid success at the initial offer announcement is important. It tends to produce bid premium at about 25-30% when the true offer premium according to Betton, Eckbo and Thorburn (2009) is 45-50%. In principle, the correct base price is the pre-offer secondary market price of the target which the bidder relies on in order to determine the initial bid premiums. While this base price is unobservable, it is common to select a target share price two or three months prior to the first bid. Eckbo (2008) and several of other researchers use the price 42 trading days prior to the initial offer announcement as base price. The usual reason for doing this is that a price this far back from the initial bid is largely free of market anticipation of the pending offer (Ekcbo 2008).

4 Data

Our sample at this moment contains mergers and acquisitions announced between March 1, 1986 and December 31, 2010, reported by SDC (Merger and Acquisitions database), a database from Thomson Financial, which professor Øyvind Norli from BI Norwegian School of Management has kindly provided us with. This data includes a sample on 19305 deals in total. To investigate whether the nationality of Chinese firms is a cross-sectional determinant of the bid premium, we select only bids made by Mainland China, Hong Kong and Taiwan, for targets outside these areas. This reduces our sample to158 deals.

By adding similar restrictions to the Zephyr (Mergers and Acquisitions) database we find a sample at about the same size. However, a larger portion of these deals are European.

In the Deloitte publication; "The emergence of China: New frontiers in outbound M&A" (2009), a third M&A database, mergermoney, is used. In this report the authors carefully describe reasonable restrictions for narrowing down

the number of deals; Chinese outbound deals only, controlling stake, deal value above US$ 5 M, only completed deals, etc., and end up with 437 deals between 2003 and 2009. This includes both private and public deals. We will contact Deloitte, or if necessary others, in order to access this data.

We hope to be able to run the same regression, with the same control variables on all 3 datasets.

5 Methodology

In order to examine whether firms from China (versus other countries) pay a higher premium when bidding for firms outside of China, we adopt and expand on the empirical model used by Rossi and Volpin (2004). The following regression model is estimated;

$$\text{Log (Premium)}_i = \alpha_0 + \beta_1 \text{ (China) } + \beta_2 \text{ (Control variables)} + e_i$$

We will regress the log of the bid premium, in which the premium is the bid price as percentage of the target's closing price four weeks before the announcement of the deal, on an indicator variable for the bidder's country (equal to one for Chinese firms and zero otherwise).

We will include control variable identified by prior literature, and are motivated by Betton, Eckbo, and Thorburn (2008b) which group the explanatory variables into target characteristics, bidder characteristics, and deal characteristics. The target characteristics control variables include among others; target firm size (log of net assets), target current profit margin, and target industry fixed effect (using two-digit SIC codes) which captures factors such risk and growth characteristics. When it comes to deal characteristics that could influence the transaction, consistent with Rossi and Volpin (2004), we control for competing bids, tender offers, whether the bid is hostile or not and whether the bid is for cash or stock. Finally, the bidder characteristics which will be among the control variables are positive toehold and whether or not it is a horizontal takeover (Eckbo 2009).

6 Summary and way forward

In this preliminary thesis report we have reviewed previous literature from relevant papers regarding the topic chosesn. Our intention is to extend the litterateur review and we see that the challenge lies in selecting the most relevant once and those that may best contribute to our work and lead us in the right direction. Further, we have described our research question and hypothesis and presented the data we have so far. The way forward is to complement the data and find the most relevant control variables to be able start analyzing the data. We hope to find some interesting results to present in our final Master Thesis; it would be particular exciting since we cannot find any academic research that has already investigated the specific hypothesis and because in our opinion is a particular interesting topic considering the situation and development of Chinas role in the world economy.

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