

CROSS-BORDER M&A AND FIRM VALUE: EVIDENCE FROM CHINESE ACQUISITIONS OF JAPANESE FIRMS

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Abstract

We study the effect of mergers and acquisitions by Chinese acquirers of Japanese targets (China-Japan M&As) on the firm value. Using the data on China-Japan M&As in 1990-2009, we find that China-Japan M&As show a greater positive effect on stock prices for the targets than for the acquirers. We also observe the following tendencies: 1) the lower the management efficiency of the target is, the greater the market reactions are; 2) a bailout M&A generates greater market reactions for targets than does a non-bailout M&A; 3) capital participation imparts greater market reactions for the target than occur with other forms of M&A; and 4) targets experience smaller market reactions from the subsidiary sales than occur with other forms of M&A.*****

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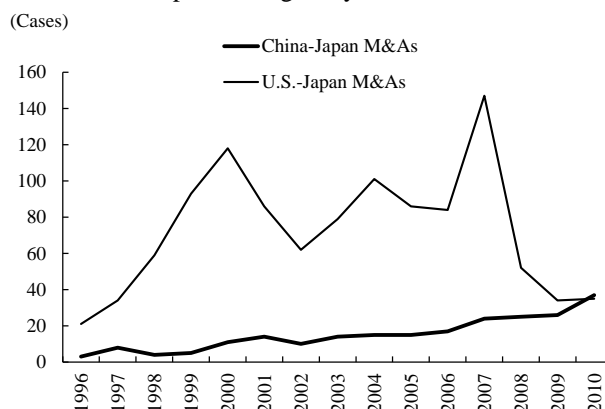
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1 Introduction

We examine the effects of the growing number of mergers and acquisitions by Chinese firms of Japanese firms (China-Japan M&As) in recent years. The number of M&As targeting Japanese firms by firms in developed countries declined drastically following the Lehman crisis in 2008, along with a

world-wide shrinking of cross-border M&As. In contrast, the number of M&As targeting Japanese firms by Chinese firms steadily increased (Figure 1). According to the Nikkei Newspaper (Nihon Keizai Shimbun in Japanese) on October 28, 2010, Chinese firms became the top acquiring firms of Japanese firms in 2010 for the first time since 1985.

Figure 1. M&As of Japanese targets by American and Chinese acquirers



Source: RECOF M&A database. Note: China includes Hong Kong.

Reports on individual cases provide mixed evaluations of China-Japan M&As: some cases are praised highly for generating favorable synergy effects between a Japanese target and a Chinese acquirer, while other cases are criticized for bringing Chinese rivals into the Japanese market. An example of the former is the acquisition of Laox by Suning Appliance Co., Ltd., which was announced on June 24, 2009. The Nikkei Newspaper reported on June 25 that this M&A could benefit both firms via reducing costs by cooperative purchasing of home electronics products and development of private brand products. An example of the latter is Haier Home Electronics Appliances' purchase of the major household appliances units of SANYO Electric Co., Ltd., a subsidiary of Panasonic Corp. Although Panasonic aimed to restructure businesses that overlapped with those of SANYO Electric, this deal provided competitive technology to and shared a sales network with Panasonic's own rivals and thus can be regarded as Panasonic's "showing humanity even to one's enemy."¹

The authors of many prior studies have investigated the impact of M&As on the target and acquiring firms. However, few studies have focused on M&As of firms in developed countries by firms in developing countries. In addition, it is not reasonable to assume that previously accepted hypotheses regarding cross-border M&As between firms in developed countries are applicable to China-Japan M&As. In fact, the M&As by firms in developing countries are suspected to be a channel for leakage of advanced technology and to infringe upon national interests. If this suspicion is correct, the M&As by Chinese acquires are less likely to increase the firm value of Japanese targets than are the M&As by firms in advanced countries. Using these developments as a basis, we examine how M&A practice and firm characteristics are associated with stock price reactions to the announcement of M&As based on the data on the 66 listed acquirers and 107 listed targets in China-Japan M&As between 1990 and 2009.

We find that as a whole, M&A announcements show a greater positive effect on targets compared with effects on the acquirers. We also observe the following tendencies: 1) the lower the management efficiency of the target is, the greater the stock price reactions to China-Japan M&As are; 2) a bailout M&A generates greater stock price reactions for targets than does a non-bailout M&A; 3) capital participation imparts greater stock price reactions on the target than occur with other forms of M&A; and 4) targets experience smaller stock price reactions from the subsidiary sales than occur with other forms of M&As. The first finding is consistent with the hypothesis previously accepted by studies on M&As

between firms in developed countries, while the other three findings are not.

The rest of this article is organized as follows. Section 2 describes the background of China-Japan M&As. Sections 3 and 4 provide a literature review of empirical studies that examine market reactions to M&As and hypotheses development, respectively. Our methodology and data are described in Section 5. Our empirical results are discussed in Section 6. Sections 7 and 8 provide sensitivity analysis and concluding remarks, respectively.

2 Background information

The China-Japan M&A is a variant of Chinese foreign direct investment (FDI) in Japan.² According to the Ministry of Economy, Trade and Industry (METI), 78 percent of investment in Japan took the form of M&As in 2005 (METI, 2007). As the M&A is the most popular form of FDI, this section describes the development of FDI in Japan and then the development of China's FDI policies and practices.

2.1 FDI in Japan

Following WWII, Japan's Foreign Investment Law of 1950 prohibited the inflow of foreign capital with exceptions for desirable investments. Although the exceptions were broadened gradually, the prohibitive nature with procedural complexity remained until the law was abolished and replaced by the Foreign Exchange and Foreign Trade Control Law of 1980. The new law imposed restrictions only in exceptional cases, with streamlined procedures (Tatsuta, 1981).

The liberalization of inward FDI was promoted to resolve structural issues, reflected in the growing current account imbalance between Japan and the U.S. However, amounts of inward FDI remained far smaller than FDI by Japan's. Under the Structural Impediments Initiative between the two countries, in 1990, the Japanese government issued the "Declaration Concerning Openness to Foreign Direct Investment." Following the collapse of the economic "bubble" and the subsequent economic slowdown in the 1990s, several measures were taken to enhance capital inflows, which were expected to revitalize the Japanese economy and promote structural reform. These measures included the establishment of the Japan Investment Council (JIC) and improvements to the environment for M&A activities (Wada, 2005).

Despite these policy initiatives, inward FDI to Japan remained quite low from the 1990s to the early 2000s. According to the Ministry of International Trade and Industry (MITI), the outstanding amount of FDI in Japan was approximately \$50 billion in 2000, which accounted only for 1 percent of the Japanese GDP, far less than that to the other G7 countries,

¹ For example, please refer to the following article by J-CAST News (in Japanese): <http://www.j-cast.com/2011/08/07103305.html?p=all>

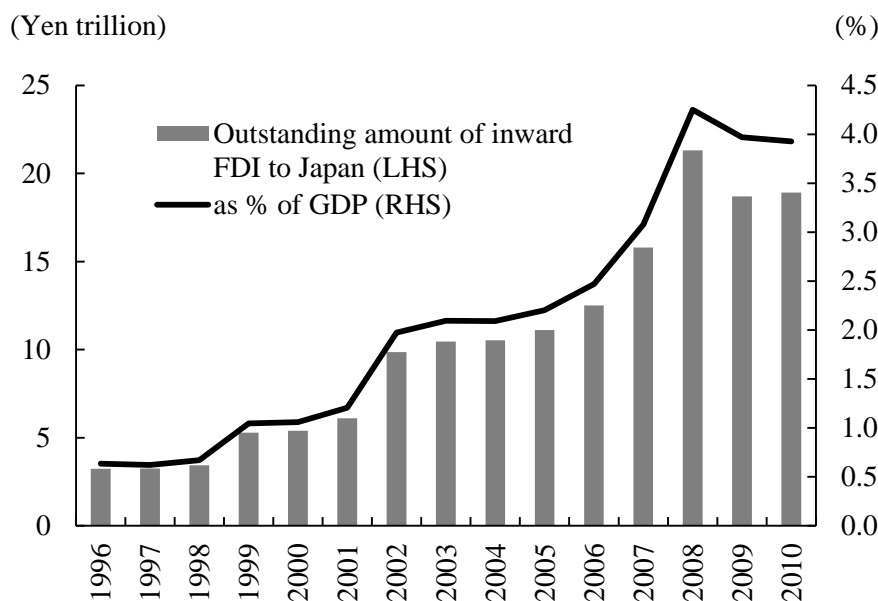
² FDI takes two forms: green field investment, which is the investment to establish a brand-new firm or a production base, and the M&A.

whose FDI accounted for 22-32 percent of each country's GDP. On the basis of the continued stagnation, the Japanese government implemented a series of measures to double FDI in Japan between 2001 and 2006. In 2003, the JIC issued the "Program for the Promotion of Foreign Direct Investment into Japan" to promote structural reform and to revitalize the Japanese economy through the introduction of new technology, innovative know-how in

management, and new products, services, or money from abroad, and through job creation.

As a result of the government's continuous efforts to promote inward FDI, the FDI in Japan increased drastically between 2006 and 2008, following the reversal after the global financial crisis in 2009. According to the Japan External Trade Organization (JETRO), the outstanding amount of FDI reached approximately 4 percent of the Japanese GDP in 2010 (see Figure 2).

Figure 2. FDI in Japan



Source: JETRO.

As part of the promotion of inward FDI, the government liberalized M&As of Japanese targets by foreign acquirers. A turning point of this liberalization was the introduction of the concept of a "triangular merger" on May 1, 2007. The triangular merger is a merger in which the acquiring firm provides shares of its parent firm to shareholders of the target firm instead of its own shares. It should be noted that the "triangular merger" has no restriction with regard to the nationality of the parent firm of the target firm. Before that, equity swaps and equity transfers had been allowed only for domestic firms and not for foreign firms since 1999, when the Commercial Code and tax system were revised. Thus, the triangular merger removed the restriction for foreign firms that were involved in cross-border M&As.

2.2 China's FDI policies and practices

Since China enacted the Reform and Opening-up Policy in 1978, the Chinese government was eager to host FDI and became one of the largest capital importers of the world. After initial rapid economic growth, however, China also became compelled to invest abroad to seek profitable investment

opportunities for the accumulated foreign exchange reserves that were generated from the huge trade surplus.

The Chinese policies covering outward FDI can be classified into two periods, the regulated period (1978-1990s) and the liberalization period (2000s-).³ From the beginning of the Reform and Opening-up Policy until the early 1990s, outward FDI by Chinese firms was basically prohibited with some special exceptions. For example, Chinese firms were not fully qualified to implement overseas investment, and firms wishing to invest abroad had to utilize overseas technologies, resources, and markets to make up for shortages of these factors in China. This implied that the Chinese economy could not afford to invest abroad because it suffered from serious shortages of foreign exchanges and technologies in its domestic market.

The basic principle of the policies on outward FDI shifted from regulation to liberalization in the 2000s. This change was brought about by the "Going Out" strategy under the 10th Five-Year Plan (2001-

³ For details of China's overseas investment policies, see Wenbin and Wilkes (2011), for example.

2005). Based on this strategy, the Chinese government formulated several policies favorable to outward FDI, which included simplified application procedures and raising the upper limit of investment in 2004. The Chinese government used to control outward FDI, but changed its policy to supporting the decisions made by firms investing overseas.

At the same time, in 2003, the National Development and Reform Commission (NDRC) and China's Export-Import (EXIM) Bank published the "Circular on Prior Support to Significant Overseas Investments." Through this policy the NDRC and EXIM Bank provided financial support to overseas investments for securing natural resources, introducing advanced technologies, and exporting goods and labor from China. In May 2005, the Ministry of Commerce and EXIM Bank published the "Circular on Implementing the Import and Export Privilege Credit Insurance to Support Individual and Private Companies to Develop International Markets," which raised the upper limit of foreign exchange for outward investment from \$3.3 billion to \$5 billion.

Based on these developments, the current policy environment in China is supportive of outward FDI, which has attracted global attention. According to the Chinese Ministry of Commerce, outward FDI flow from China recorded less than \$3 billion in 2003, but after a drastic increase, it reached \$59 billion in 2010, a 36.3% increase from the previous year. Outward FDI from China reached approximately \$280 billion by the end of 2010, which was in sharp contrast to the stagnated overseas investment by the advanced countries after the global financial crisis.

3 Literature review

Prior empirical studies on the effects of M&As typically use either an event study or a performance study methodology. Based on the efficient market hypothesis, the event study estimates abnormal returns (ARs) of stock prices around the announcement of M&As and tests whether the ARs are significantly different from zero. The performance study compares key financial data of target or acquiring firms such as return on assets (ROA) and sales ratios before and after M&A transactions to determine whether the financial conditions have been improved after M&A transactions. Because stock prices are expected to reflect all information related to future corporate performance, we employ the event study methodology to evaluate the impact of China-Japan M&As on firm value, although we acknowledge the limitation of this methodology, that is, the difficulty in examining whether *ex ante* expectation is realized *ex post*.⁴

This section provides a brief review of the related empirical literature that investigates the effects of M&As on firm value by using the event study methodology. In particular, we mainly review the following two types of empirical studies: those examining domestic M&As within the U.S. or Japan, and those examining cross-border M&As. Although most of the empirical studies show that M&A announcements increase stock prices of target firms, how the announcements affect acquiring firms depends on circumstances and conditions.

In their influential paper on American M&As, Andrade et al. (2001) analyze M&As that took place from 1973 to 1998 between firms listed on the New York Stock Exchange (NYSE), AMEX, or NASDAQ. They find that M&A announcements tend to increase stock prices of target firms but decrease those of the acquiring firms. In contrast, prior empirical studies on Japanese M&As provide different results with regard to the wealth effect of M&As on acquiring firms (Kang et al., 2000; Inoue and Kato, 2006; Kakuda and Takeda, 2006; Hanamura et al., 2011). For instance, Kang et al. (2000) examine stock price reactions to the Japanese domestic M&As between 1997 and 1993, finding that cumulative abnormal returns (CARs) for acquiring firms are significantly positive, except for acquisitions motivated by rescue purposes, which provide significantly negative CARs for acquirers.

More recently, Inoue and Kato (2006) examine M&As between listed firms that took place from 1990 to 2002. They document that M&A announcements tend to increase stock prices for both target and acquiring firms, and that the market reaction is larger for target firms than for acquiring firms. In addition, Kakuda and Takeda (2006) investigate M&As that were publicly announced between 2002 and 2003, while Hanamura et al. (2011) analyze M&As that took place between 2000 and 2007. Both papers provide results similar to those of Inoue and Kato (2006). That is, M&A announcements provide positive effects on stock prices of both target and acquiring firms.

Based on the difference in estimated effects of M&As on acquiring firms between the U.S. and Japan, the next question is what causes this difference. Inoue and Kato (2006) attribute the differences to the varied purposes and conditions of M&As between the two countries. For example, M&As between U.S. firms that took place in the 1980s were mostly hostile takeover M&As, and in some cases there were multiple potential acquirers competing for acquisition. Such hostile M&As are costly, because acquiring firms are burdened with huge merger premiums or the necessity to replace management personnel. In contrast, M&As between Japanese firms were less costly because hostile or contested M&As were very exceptional.

Prior empirical studies on cross-border M&As also provide mixed results with regard to market

⁴ Inoue and Kato (2006) discuss the pros and cons of event study and performance study methodologies and choose the former.

reactions to the M&A announcements. Table 1 presents a summary of these studies. Although several studies report positive responses, other studies, which mainly focus on cross-border M&As among European countries, document negative responses. As an example of a positive response, Kang (1993) investigates the M&As of U.S. target firms by Japanese acquirers between 1975 and 1988. He finds that M&A announcements tend to increase stock prices for both the U.S. target and the Japanese acquiring firms, and that stock price responses increase with the acquirers' leverage, their ties to financial institutions through borrowings, and the depreciation of the dollar against the yen. He also reports that U.S. targets of Japanese acquiring firms realize the greatest differential returns when they sell a majority interest to Japanese acquirers.

Prior empirical studies examining the effects of cross-border M&As involving the U.S. acquiring firms also report the positive effects of such acquisitions (Markides and Ittner, 1994; Doukas 1995; Moeller and Schlingemann, 2005; Wooster, 2006; Freund et al., 2007; Francis et al., 2008), except for Datta and Puia (1995). For instance, Moeller and Schlingemann (2004) examine cross-border M&As by U.S. acquirers that took place between 1985 and 1995. They report that M&A announcements tend to increase stock prices of the acquiring firms, although the market reaction is larger for domestic M&As than for cross-border M&As. Wooster (2006) focuses on M&As of Central and East European firms by the U.S. firms between 1987 and 1999, finding positive wealth effects for the U.S. acquiring firms.

With regard to the impact of cross-border M&As by acquiring firms in countries other than the U.S. and Japan, prior empirical studies provide mixed results (Cakici et al., 1996; Goergen and Renneboog, 2004; Conn et al., 2005; Gregory and McCorrison, 2005; Aybar and Ficici, 2009). Cakici et al. (1996) examine cross-border acquisitions of U.S. target firms between 1983 and 1992, finding that foreign acquirers gain significantly from purchases of U.S. firms. Goergen and Renneboog (2004) investigate cross-border M&As among European firms, documenting that M&A announcements increase stock prices for both target and acquiring firms and that the market reaction is larger for target firms than it is for acquiring firms. In contrast, Conn et al. (2005), Gregory and McCorrison (2005), Aybar and Ficici (2009) do not find a positive wealth effect from cross-border M&As by acquiring firms in Europe and emerging countries.

4 Hypotheses development

As discussed in the previous section, prior empirical studies on domestic and cross-border M&As show that M&A announcements tend to increase the stock prices of target firms, and that how the announcements affect acquiring firms depends on circumstances and conditions. Because the effect of

M&As varies across countries, we want to examine how China-Japan M&As affect stock prices of acquiring and target firms, and to that end we develop four hypotheses to consider the factors influencing stock price reactions. We note that these four hypotheses are mainly about stock price responses for Japanese target firms, as we are especially interested in how reactions are different between China-Japan M&As and domestic M&As reported in prior studies.

4.1 Management improvement hypothesis

In the U.S., improvement of management has been reported when firms with inefficient management are acquired by firms with efficient management (Lang et al., 1989). The Q ratio, which is the market value of a firm divided by the replacement cost of capital (capital stock), is frequently used to measure the efficiency of corporate management (Tobin and Brainard, 1977). This Q ratio is the basis for determining whether an investor will make additional investments, and it can also be used to measure a corporation's management efficiency: the higher the Q ratio is, the better a firm is managed. Firms with a Q ratio less than 1 are inefficiently managed and are not using the firm's asset value effectively.⁵

When using the Q ratio as an indicator of management efficiency under a current management team, we can predict a management improvement effect after M&A of a target firm with a low Q ratio by an acquiring firm with a high Q ratio, because of efficient operation through reallocation of assets or more efficient management by changes of management. In fact, the impact that the Q ratio has on stock prices of the firms engaged in M&A has been well researched. For example, Dong et al. (2006) analyze the M&A activities among firms listed on the NYSE, AMEX, and NASDAQ from 1978 to 2000. They show that 1) the lower the Q ratio of the target firm, the greater the positive effect on its stock price, and the lower the negative effect on the acquiring firm's stock price; and 2) the higher the Q ratio of an acquiring firm, the greater the positive effect on the stock price of the target firm, and the greater the negative effect on the acquiring firm's stock price.

⁵ A Q ratio less than 1 means the market value of a corporation is less than the value of its capital stock. In other words, the current capital stock is over-evaluated, in the sense that selling capital stock on the market leads to higher profits than investing in existing capital stock and reproducing it. On the other hand, a Q ratio greater than 1 means that the current market value of a corporation is greater than the value of its capital stock. In other words, increasing capital stock is advantageous because using and reproducing capital stock leads to a greater value for the corporation.

Table 1. Summary of related literature on cross-border M&As

Empirical studies	Targets	Acquirers	Investigation period	Empirical results
Kang et al. (1993)	U.S.	Japan	1975-1988	M&A announcements increase stock prices for both target and acquiring firms. Stock price responses increase with the acquirers' leverage, their ties to financial institutions through borrowings, and the depreciation of the dollar against the yen.
Markides and Ittner (1994)	Foreign	U.S.	1975-1988	Announcements on international M&As increase stock prices for acquiring firms, while those on domestic do not create value.
Datta and Puia (1995)	Foreign	U.S.	1978-1990	Announcements on international M&As do not increase stock prices for acquiring firms. Acquisitions characterized by high cultural distance are associated with low stock price reactions.
Doukas (1995)	Foreign	U.S.	1975-1989	M&A announcements show that acquirer ARs are substantially higher for high q acquirers than low q acquirers.
Moeller and Schlingemann (2005)	Foreign	U.S.	1985-1995	M&A announcements increase stock prices for acquiring firms. Stock price responses are larger for domestic M&As than cross-border M&As.
Wooster (2006)	Central and Eastern Europe	U.S.	1987-1999	M&A announcements increase stock prices for acquiring firms.
Freund et al. (2007)	Foreign	U.S.	1985-1998	M&A announcements increase stock prices for acquiring firms. Stock price reactions are larger for firms with lower Tobin's q than for those with higher Tobin's q.
Francis et al. (2008)	Foreign	U.S.	1990-2003	M&A announcements increase stock prices for acquiring firms.
Cakici et al. (1996)	U.S.	Foreign	1983-1992	Foreign acquirers gain significantly from purchases of U.S. firms.
Goergen and Renneboog (2004)	Europe	Europe	1993-2000	M&A announcements increase stock prices for both target and acquiring firms. The market reaction is larger for target firms than acquiring firms. A high market-to-book ratio of the target leads to a negative price reaction for the acquiring firm.
Conn et al. (2005)	Foreign	U.K.	1984-1998	Cross-border public acquisitions result in zero announcement returns, while cross-border private acquisitions result in positive announcement returns. Domestic public acquisitions result in negative announcement returns, while domestic private acquisitions result in positive announcement returns.
Gregory and McCorrison (2005)	Foreign	U.K.	1985-1994	M&A announcements do not create value for acquiring firms.
Aybar and Fici (2009)	Foreign	Emerging countries	1991-2004	M&A announcements do not create value for acquiring firms.

In addition, Hanamura et al. (2011) perform multiple regression analysis on firms listed on the first and second sections of the Tokyo Stock Exchange (TSE), which are involved in M&A between 2000 and 2007. Their results show that 1) the lower the Q ratio of a target firm, the greater the positive effect on that firm's stock price; and 2) the higher the Q ratio of the acquiring firm, the greater the positive effect on that firm's stock price. In the present study we set the following hypothesis to guide our analysis of the impact of the target firm's management efficiency on the stock price reaction to M&A:

Hypothesis 1: China-Japan M&As involving target firms with low Q ratios generate greater positive stock price responses for the target firms than do those involving target firms with high Q ratios.

4.2 Bailout effect hypothesis

While hostile M&A activity is almost unheard of in Japan, there are many instances of bailout M&As for firms otherwise unable to survive. The motives for M&As done for such bailout purposes are primarily to improve management, but can also be to provide an infusion of capital to a company starving for funding, with no change in management lineup resulting from the M&A. Bailout M&As can also be observed in China-Japan M&As.⁶

A typical case is the capital participation in Laox by the Suning Appliance Chain Store (Group) on June 24, 2009. Suning Home Appliance acquired around 1.5 billion yen worth of new shares of Laox through a third party allocation. Laox had fallen into deficit and wanted to shore up its financial standing. Suning Home Appliance made no changes to the existing management team of Laox, only sending two experienced directors to help manage and control the company. This limited replacement of management is probably because M&As by foreign acquirers are not well regarded in Japan, as the ethics and competency of employees in Japanese firms are regarded as quite high.⁷ In particular, if a management team is replaced after an M&A in Japan, it could easily give employees the impression that the assets of the Japanese firm were forcibly taken by foreign capital entities, and there would be a high risk of existing technical and management talent leaving the company.⁸

⁶ Nakamura (2010) hints that there are many poorly performing Japanese firms that received investment from Chinese corporations.

⁷ The JETRO (2004) notes that "A resistance to M&A by foreign capital persists among Japanese companies. Foreign companies have also deeply recognized that integration is very difficult in Japan, mainly due to the different cultural background."

⁸ For example, after the M&A of Akiyama Printing Machinery Co. by the Shanghai Electric Group on December 6, 2001, many Akiyama engineers temporarily quit because of the acquisition by a Chinese company, which caused great damage to the company (Niwa, 2010).

Several studies on bailout M&As have been done in Japan. However, there appears to be no set standard for determining what constitutes a bailout vs. a non-bailout M&A. For example, Kang et al. (2000) analyze the wealth effect of transactions reported by the press as having a bailout purpose. Inoue and Kato (2006) set more detailed judgment conditions and categorize transactions initially reported as bailouts in the press. In addition, they include the following two cases in the bailout category, even though they were not reported as so in the press. The first case is where the target firm recorded either a net loss or an operating loss for at least two of the three fiscal terms prior to the M&A announcement. The second case is where there is no dividend at the time of the M&A announcement and no dividend expected for the following term. These conditions indicate that the firms had difficulty rebuilding management on their own, and thus they can be regarded as firms acquired for the purpose of bailing them out. Inoue and Kato (2006) report that there is a significantly positive effect on stock prices for both acquiring and target firms involved in a non-bailout M&A, but for bailout M&As, there is a negative market reaction for acquiring firms and a positive but insignificant response for target firms. Accordingly, we formulate the following hypothesis:

Hypothesis 2: China-Japan M&As based on a non-bailout purpose generate greater positive stock price reactions for the target firm than do those based on a bailout purpose.

4.3 M&A structure hypothesis

The RECOF Corporation's M&A database⁹ classifies M&A structures according to the following five categories: mergers, acquisitions, business transfers, capital participation, and investment expansion. Mergers are the situation in which two or more parties agree to merge into one company through a merger contract. Mergers conducted by stock transfers are integrations wherein shares are transferred to form a joint holding company. Mergers by stock exchange are integrations wherein Company A splits to form a holding company prior to the stock exchange, and that holding company exchanges shares with Company B.

Acquisitions are usually done by obtaining more than 50% of a company's shares. Acquisitions may also include situations with no more than a 50% acquisition of shares where management control is obtained (see Companies Act, Article 2, Item 3). Examples include underwriting of a capital increase, acquisitions by existing shareholders, and exchanges of shares. In addition, the result of a company split where the split company becomes the parent of the successor company is classified as an acquisition. The result of a merger where the parent of a merged

⁹ The explanation of the RECOF M&A database is provided in Section 5.

company becomes the parent of the surviving company can also be categorized as an acquisition.

Business transfers are the moving of assets, employees, or goodwill and other property among two or more companies. This includes the integration of existing businesses between two companies. Company splits are, in principle, categorized as business transfers. However, this does not apply to cases where the successor company becomes a subsidiary. Capital participation means an acquisition of no more than 50% of shares. However, this does not apply to cases where the corporation becomes a subsidiary. It is the undertaking of a capital increase or acquisition of stock by existing shareholders. This is also limited to first-time acquisitions only. Investment expansion is another acquisition of no more than 50% of shares by capital participation parties. However, this acquisition of shares is excluded from acquisition or investment expansion, in the case of investments already greater than 50% or with the goal of forming a subsidiary.

Several prior studies on M&A structures in Japan feature a comparative analysis among different M&A structures. For example, Inoue and Kato (2006) compare M&As by share exchange and stock transfer with those by mergers and takeover bids (TOB) to show that the former generates a greater positive stock price reactions for both the acquiring and target firms. They point out that this is because the Commercial Act revisions enacted in October 1999 created additional options for transaction structures, and this led to a decrease in transaction cost, including the cost of integration. Kakuda and Takeda (2006) also compare M&As by stock exchange with M&As by mergers and stock transfers, and find that the former has greater positive stock price reactions for both acquiring and target firms listed on Japanese markets between 2002 and 2004.

Okabe and Seki (2006) examine M&A activities in Japan in 2001 based on data from 157 acquiring firms. They conclude that 1) in an M&A transaction, the effect on the acquiring firm varies greatly depending on the M&A structure; and 2) M&As with capital participation or business transfers have a relatively greater stabilizing effect and management efficiency effect,¹⁰ while acquisitions have a clearly small impact on both of these. We use the M&A categories set forth based on the RECOF M&A database.¹¹

¹⁰ The stabilizing effect means "to raise trust in that corporation within the market." On the other hand, the management efficiency effect refers to "a growth in the value of products generated by various kinds of resources (physical and human resources as well as technology and intangible assets) under control of a corporation" (Okabe and Seki, 2006: pp. 18-19).

¹¹ Our reason for doing so is that publicly available information for China-Japan M&As at the time of the transaction is limited, and it is difficult to use other forms of classification. In particular, transactions where Japanese firms enter the Chinese market by forming a joint venture company with a Chinese firm, and then subsequently sell

Our sample has very few firms in each category other than acquisitions and capital participation, and thus we categorize all transactions outside of these two categories as "other structure." In referring to the results of previous research, we note that, among the various M&A structures, M&As by capital participation result in greater stabilizing and efficiency effects on the acquiring firm, and capital participation has lower transaction costs than acquisitions (Okabe and Seki 2006). We thus form the following hypothesis:

Hypothesis 3: China-Japan M&As by capital participation generate greater positive stock price reactions for both the acquiring and target firms than those generated by the other structures.

4.4 Carve-out (subsidiary sale) hypothesis

When overseas and domestic subsidiaries of Japanese firms become target firms, the parent company is also classified as a target firm in the RECOF M&A database. Thus, acquisitions of the overseas subsidiaries of Japanese firms or joint venture corporations by a Chinese partner are categorized as out-in M&As. Accordingly, in the present study, if the subsidiary is not listed, we use the share price of the parent instead.

Research has also been done to examine the impact on the performance of a parent company when a subsidiary is sold, a process known as a carve-out. By analyzing carve-outs occurring between 1970 and 1993 on the NYSE, AMEX, and NASDAQ, Slovin and Sushka (1998) determine that a parent's sale of a subsidiary to a third party tends to significantly increase the share price of the parent, although it significantly reduces the share price of the third party. Inoue and Kato (2006) note that "carve-outs that reduce the size of a corporation can be appropriate actions from an economic rationale, and can be an option to increase shareholder value." Based on these prior studies, we can expect that sales of subsidiaries to third parties are likely to increase the share price of the target firm, and that they tends to increase the share prices of both subsidiaries and parents. Accordingly, we set forth the following hypothesis:

Hypothesis 4: The sale of a subsidiary to a Chinese acquirer generates greater stock price reactions for the Japanese parent, i.e., the target firm, than those generated by the other forms of China-Japan M&As.

In addition to testing the above four hypotheses, we also examine the effect of other factors on stock price reactions to China-Japan M&As. These factors include 1) markets wherein both the acquired and the

their share in the joint venture to the Chinese partner when they withdraw from the Chinese market, fall under the purview of this research, but in some cases, there is no information about it in the Japanese press. Accordingly, there is no basis for determining whether these are share exchange transactions or stock transfer transactions.

acquiring firms are publicly traded; 2) a type of industry of the acquired and the acquiring firms; and 3) the region of the acquiring company (mainland China and Hong Kong).

5 Methodology and data

5.1. Methodology

To examine market reactions to Chinese M&As in Japan, we employ a standard event study methodology. The event day here is the disclosure of China-Japan M&As. We take two-day (0, +1) and four-day (0, +3) event windows. The estimation window is set at 150 trading days before the event window. We estimate the standard market model for the estimation window as follows:

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

$$E[\epsilon_{it}] = 0 \quad \text{Var}[\epsilon_{it}] = \sigma_{\epsilon_i}^2$$

where R_{it} represents the stock price return of firm i at period t , R_{mt} is a return on market portfolio at period t , and ϵ_{it} is a disturbance term.

By using the estimated parameters, we can calculate the abnormal return (AR), as follows:

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

$$AR_{it} \sim N(0, \sigma^2(AR_{it})) \quad (2)$$

$$\sigma^2(AR_{it}) = \sigma_{\epsilon_i}^2 + \frac{1}{L_1} \left[1 + \frac{(R_{mt} - \mu_m)^2}{\sigma_m^2} \right]$$

where L_1 is the length of the estimation window, which starts at t_1 and ends at t_2 . The CAR and standardized CAR (SCAR) are obtained as follows:

$$CAR_i(t_1, t_2) = \sum_{t=t_1}^{t_2} AR_{it}$$

$$CAR_i(t_1, t_2) \sim N(0, \sigma^2(t_1, t_2)) \quad (3)$$

$$\sigma^2(t_1, t_2) = (t_2 - t_1 + 1) \sigma_{\epsilon_i}^2$$

$$SCAR_i(t_1, t_2) = \frac{CAR_i(t_1, t_2)}{\sigma(t_1, t_2)}$$

The average CAR (CAAR) for groups of firms is calculated as follows:

$$CAAR(t_1, t_2) = \frac{1}{N} \sum_{i=1}^N CAR_i(t_1, t_2),$$

$$\text{Var}[CAAR(t_1, t_2)] = \frac{1}{N^2} \sum_{i=1}^N \sigma_i^2(t_1, t_2), \quad (4)$$

where N is the number of firms within the same subsample. We set the null hypothesis H_0 : $CAAR(t_1, t_2) = 0$ and test whether this H_0 can be statistically rejected. To test H_0 , we can use a J_1 -statistic, and we also use a J_2 -statistic based on SCAR to guarantee robustness, as follows.

$$J_1 = \frac{CAAR(t_1, t_2)}{[\sigma^2(t_1, t_2)]^{\frac{1}{2}}} \sim N(0, 1)$$

$$SCAAR(t_1, t_2) = \frac{1}{N} \sum_{i=1}^N SCAR_i(t_1, t_2) \quad (5)$$

$$J_2 = \left(\frac{N(L_1 - 4)}{L_1 - 2} \right)^{\frac{1}{2}} SCAAR(t_1, t_2) \sim N(0, 1)$$

We first conduct univariate analysis to analyze the type of factors that influence targets' CAR. The analysis uses the seven afore-mentioned categories, namely, 'management efficiency;' 'bailout purpose;' 'M&A structure;' 'subsidiary sale;' 'industry sector;' 'stock exchange of listing;' and 'location of acquiring firms.' We then conduct multivariate analysis, examining all of these variables. We also include in the control variables some factors other than the seven listed above, which may feasibly have an impact on CAR, using the following model:

$$\begin{aligned} CAR_{(0,+3)} = & \alpha + \beta_1 PBR + \beta_2 BailouZ \\ & + \beta_3 Method \\ & + \beta_4 Manufacturing \\ & + \beta_5 Market + \beta_6 District \\ & + \beta_7 Equityratio + \beta_8 Asset \\ & + \beta_9 ROA + \epsilon \end{aligned} \quad (6)$$

where $CAR_{(0,+3)}$ denotes CARs of the target firm over a four-day window (0, +3). A summary of each explanatory variable is presented in Table 2.

Table 2. Definitions and predicted correlation signs for explanatory variables

Explanatory variable	Definition	Related hypothesis / prediction	Predicted correlation with CAR (+/-)
PBR	Price-to-book ratio of the target firm	Management improvement	–
Bailout	Dummy variable that takes 1 if China-Japan M&A has a bailout purpose, 0 otherwise.	Bailout effect	–
Method	Dummy variable that takes 1 if China-Japan M&A is made by capital participation, 0 otherwise.	M&A structure	+
Manufacturing	Dummy variable that takes 1 if the target firm is in a manufacturing sector, 0 otherwise (non-manufacturing sector).	Industry sector	–
Market	Dummy variable that takes 1 if the target firm is listed on the emerging stock exchange, 0 otherwise.	Stock exchange	–
District	Dummy variable that takes 1 if the acquiring firm is located in Hong Kong, 0 otherwise (mainland China).	Location of acquiring firms	–
Equityratio	Target's rate of equity on total assets	Financial security of the target firm	–
Asset	Logarithm of total assets of the target firm	Size of the target firm	–
ROA	Target's rate of return on total assets	Profitability of the target firm	–

The price-to-book ratio (PBR) is a proxy for the Q ratio and is calculated as follows:

$$\text{Price-to-Book Ratio (PBR)} = \frac{\text{Share Price}}{\text{Net Assets per Share}} \quad (7)$$

PBR is an indicator of business efficiency to test the management improvement hypothesis (*Hypothesis 1*) described in sub-section 4.1. The Q ratio of less than 1 indicates a company running an inefficient business that cannot fully realize its asset value potential. Thus we classify companies as 'efficient management' or 'inefficient management' depending on whether $\text{PBR} > 1$ or $\text{PBR} < 1$, respectively. Based on the management improvement hypothesis (*Hypothesis 1*), which states that the lower the Q ratio of the target firm, the more positive the effect of the M&A on its share price, we predict a negative correlation between PBR, as a proxy for the Q ratio, and CAR.

Bailout is the dummy variable coded 1 for a China-Japan M&A based on a bailout purpose and 0 otherwise. This variable is included to test the bailout effect hypothesis (*Hypothesis 2*) described in sub-section 4.2. In the previous studies, one of the criteria for deciding whether an M&A is for bailout purpose is whether or not newspaper reports it as so. However, our sample includes hardly any cases from the M&A records in the RECOF M&A database or from the newspaper articles searched at Nikkei Telecom 21, where the word 'bailout' is directly employed. Therefore, in this study, M&A deals deemed to have a 'bailout objective' are classified, in line with Inoue and Kato's (2006) evaluation criteria, as those where the target firm has shown a deficit in more than 2 out of 3 fiscal years preceding the announcement of the deal, or where no dividend has been paid in the accounting period immediately preceding the announcement. Our bailout effect hypothesis (*Hypothesis 2*) states that there is less market reaction for the target firm in a China-Japan M&A based on a bailout purpose than for the target firm in an M&A

based on a non-bailout purpose. Therefore, we predict a negative correlation between the Bailout dummy variable and CAR.

Method is the dummy variable coded 1 for capital participation and 0 otherwise. This variable is included to test the M&A structure hypothesis (*Hypothesis 3*) described in sub-section 4.3. The RECOF M&A database categorizes M&A structures as 'capital participation,' 'investment expansion,' 'acquisition,' and 'business transfer.' However, there are few firms that fall into only a single category, so we categorize 'capital participation' and 'acquisition' separately and the rest of the samples as 'other structures.' In fact, capital participation and acquisitions make up the overwhelming majority of all our sample cases (43 and 46 cases, respectively, amongst a total of 107 cases). Our *Hypothesis 3* states that a China-Japan M&A through capital participation generates greater positive effects on stock prices for the target firm than does an acquisition. Consequently we predict a positive correlation between the Method dummy variable and CAR.

Manufacturing is the dummy variable coded 1 if the target firm is classified as a manufacturing company and 0 if it is classified as a non-manufacturing company. Using this variable, we can measure the impact of the target's industry sector on CAR. We use fundamentally the same categories for the industry sector as those defined in the RECOF M&A database (Table 3). However, as the number of samples falling under each industry sector is deemed few, we divide them into two industry sectors, 'manufacturing' and 'non-manufacturing.' If the target firm is a manufacturing company, it may face fears regarding the technology drain, which is likely to reduce the future firm value, compared to a non-manufacturing company. Therefore, we predict a negative correlation between the Manufacturing dummy variable and CAR.

Table 3. Industry composition

RECOF Data Industry Sector Classifications	No. of samples in each industry sector	
	Acquirer	Target
Manufacturing	27	51
Agriculture, Forestry and Fisheries	1	0
Mining	1	2
Construction	0	1
Foodstuffs	2	5
Textiles	0	2
Paper/Pulp	0	1
Chemicals	1	3
Pharmaceuticals	1	1
Coal/Oil	0	0
Rubber	0	1
Publishing/Printing	0	0
Ceramics	0	3
Iron/Steel	2	1
Non-ferrous Metal Products	2	6
Machinery	2	2
Electrical Machinery	11	13
Transport Equipment	1	6
Precision	1	0
Other Manufacturing	2	4
Non-manufacturing	39	56
General Trading Company	0	1
Food Wholesaler	1	0
Pharmaceutical Wholesaler	0	1
Other Sales – Wholesaler	5	6
Department Store	3	1
Supermarket/Convenience Store	1	6
Consumer Electronics Store/HC	2	1
Other Retailer	1	1
Restaurant	0	1
Banking	3	2
Credit Union/Association	0	0
Life Assurance/Insurance	0	0
Securities	0	2
Other Financial	8	1
Transport/Warehousing	0	3
Electricity/Gas	1	1
Communications/Broadcasting	1	3
Real Estate/Hotel	2	4
Amusements	1	3
Software/Data	6	10
Service	4	9

Market is the dummy variable coded 1 if the target firm is listed on an emerging stock exchange (TSE Mothers, OSE Hercules, JASDAQ) and 0 if it is listed on the TSE or other regional stock exchanges. Using this variable, we can measure the impact of the stock exchange where the target is listed on CAR. Classification is carried out according to the stock

exchange where each of the companies involved has its main listing (Table 4). The future income from shares of target firms listed on emerging market stock exchanges is regarded as more uncertain than that of other stock exchanges, and we therefore predict a negative correlation with CAR.

Table 4. Stock exchange of listing

Panel A: Stock exchange for Acquirers	
Stock exchange	No. obs
Hong Kong	40
Shanghai	14
Others	12
Shenzen	7
JASDAQ	2
NYSE	3
Panel B: Stock exchange for Targets	
Stock exchange	No. obs
TSE 1st section	54
TSE 2nd section	13
OSE 1st section	3
OSE 2nd section	5
Emerging	
JASDAQ	21
TSE Mothers	6
OSE Heracles	3
Nagoya Centrex	1
Hong Kong	1

The acquiring firms are mainly listed on the Shanghai or Shenzhen stock markets on the Chinese mainland, or on the Hong Kong exchange. Some of the acquiring firms are also listed on the NYSE or JASDAQ, but they are few in number and have been combined under the heading 'Others,' along with those listed on the Shenzhen exchange, which has the fewest listed companies amongst China's three major stock markets. District is the dummy variable coded 1 if the target firm is located in Hong Kong and 0 if it is located on mainland China. Using this variable, we can measure the impact of the acquirer's location on CAR. In the RECOF M&A database, under the nationality of acquiring firms, the Hong Kong Chinese companies are specifically noted and differentiated from the companies on mainland China. Acquirers located on the mainland China are naturally regarded as having less experience with cross-border M&As compared with those located in Hong Kong and so can be expected to pay a higher acquisition premium, which will be beneficial for the target firm. Consequently, we predict that with the District dummy variable will have a negative correlation with CAR.

The remaining three variables – Equity Ratio, Asset, and ROA – are included to capture the financial condition of the target firms. The equity ratio is a measure of the capital adequacy of the target firm. It is calculated as shown in equation (8). Using this variable, we can measure the impact of the target's financial security on CAR.

$$\text{Equity Ratio} = \frac{\text{Owner's Equity}}{\text{Total Assets}} \quad (8)$$

On the subject of Japanese M&A, Arikawa and Miyajima (2007) suggest that the lower the equity ratio of a firm, the more susceptible it is to take-over. Consequently, we consider it possible for the equity ratio to also have an impact on the market reactions for the target firm. The lower the equity ratio of the target firm, the lower its financial security. Conversely, there is a substantial expectation that China-Japan M&As improve this financial situation and moreover, we consider that such an expectation may have a positive impact on the target's share price. In other words, we predict a negative correlation between the equity ratio and CAR.

The Asset variable shows natural logarithm of the target's total assets for the financial accounting year immediately preceding the announcement of the M&A deal. Using this variable, we can measure the impact of the target's size on CAR. The regression results provided by Dong et al. (2006) suggest that the greater the size of the acquirer in comparison to that of the target firm, the greater the target's CAR. Accordingly, we anticipate that the smaller the target firm, the greater the CAR. In other words, we predict a negative correlation between Asset and CAR.

ROA shows the rate of return on total assets for the fiscal year immediately preceding the announcement of the M&A deal. It is calculated as shown in equation (9). Using this variable, we can

measure the impact of the target's profitability on CAR.

$$ROA = \frac{\text{Profit (for the current period)}}{\text{Total Assets}} \quad (9)$$

We predict that the worse the target's profitability, the bigger the margin for improvement following a takeover, and also the greater the effects on business improvement. As such, we predict a negative correlation between ROA and CAR.

Last, based on the carve-out hypothesis (*Hypothesis 4*) described in sub-section 4.4, we estimate equation (6) by using a sample consisting only of subsidiaries. Using articles on M&A from the RECOF M&A database and newspaper reports from the time of the acquisition researched at Nikkei Telecom, we categorize 'subsidiary sales' as those where the target is a subsidiary affiliated with the parent company, or a company that is legally incorporated overseas. All other samples have been classified as 'others.'

5.2 Sample selection

We collect data on China-Japan M&As (including Hong Kong) for the period 1990-2009, using information taken from RECOF DATA Corporation's RECOF M&A database, which covers M&A projects involving with Japanese firms. The acquiring firms conform to nationality criteria that require them to be Chinese firms. Some of the acquiring firms are overseas legal entities; however, as they have taken on Chinese nationality, they have been included in our sample. We compile a list of the following data relating to the acquiring and target firms: company name; industry sector; nationality; and details of the M&A structure, including the announcement date, disclosed amounts, etc. Furthermore, as our analysis requires the use of stock prices and financial data, we

limit our scope to listed firms only, as the analysis of non-listed firms is quite difficult, due to data collection problems.

A company's stock price is essential to examine the impact of M&A on its firm value. We take acquirers' stock prices from 150 trading days prior to the M&A announcement to 3 trading days after the announcement, using China's "WIND Investment Enquiry" database. Meanwhile, targets' stock prices are obtained from the 'Kabuka CD-ROM' by Toyokeizai, Inc. The sample also consists of some firms listed in the U.S. markets, and their stock prices are taken from Google Finance. We take the financial data on targets from the EOL database for the accounting period immediately prior to the M&A announcements. However, it is difficult to obtain financial data on acquirers with Chinese or Hong Kong nationality. Moreover, as detailed below, there was no substantial impact of China-Japan M&As on the stock prices of acquirers. Therefore, in the present study, we limit the scope of our analysis to financial data of targets only.

During our sample period, there are 197 China-Japan M&A cases (Table 5). Amongst these, the 67 cases where the acquirer is listed and the 108 cases where the target firm is listed form the subjects of our research. Within these listed firms, we remove those whose stock price we are unable to obtain (e.g., acquirers with Chinese nationality, those listed on the Republic of Kenya's stock exchange). Our final sample consists of 66 acquirers and 107 targets (one case is associated with two targets and so it is recorded as a sample of two). Furthermore, for the purposes of multivariate regression analysis, the number of targets falls to 103, as we remove those companies that are yet to be listed as of the accounting period immediately prior to the M&A announcement, or, as of such period, have yet to publically disseminate any financials at all.

Table 5. China-Japan M&As for 1990–2009

	No. of M&A (A)	No. of listed acquirers (B)	(B) / (A) (%)	No. of listed target firms (C)	(C) / (A) (%)
1990	1	0	0.0	1	100.0
1991	1	1	100.0	0	0.0
1992	2	1	50.0	1	50.0
1993	1	0	0.0	1	100.0
1994	0	0	---	0	---
1995	1	1	100.0	1	100.0
1996	3	1	33.3	2	66.7
1997	8	5	62.5	3	37.5
1998	4	3	75.0	2	50.0
1999	5	1	20.0	4	80.0
2000	11	9	81.8	3	27.3
2001	14	5	35.7	4	28.6
2002	10	4	40.0	4	40.0
2003	14	6	42.9	4	28.6
2004	15	1	6.7	6	40.0
2005	15	4	26.7	7	46.7
2006	17	4	23.5	11	64.7
2007	24	4	16.7	21	87.5
2008	25	8	32.0	14	56.0
2009	26	9	34.6	19	73.1
Total	197	67	34.0	108	54.8

Source: RECOF M&A database. Compiled by authors

6 Empirical results

We first analyze the effect that announcements of China-Japan M&As have on the share prices of all the acquirers and targets (Table 6). CAARs are not significant in any of the four event windows for the 66 acquirers. However, SCAARs are significantly positive in all the event windows. This implies that China-Japan M&As tend to increase the share price of the acquirer. In contrast, both CAAR and SCAAR are

significantly positive in each event window for all 105 targets. Moreover, in all event windows, both CAAR and SCAAR greatly exceed those of the acquirers over the same period. This implies that not only do China-Japan M&As have a positive impact on the firm value of the targets, but also that the impact is greater than any positive gains made by the acquirer.

Table 6. Stock price responses to the China-Japan M&As for all samples

Panel A: Stock price responses for acquirers							
No. of acquirers	Event window	CAAR (%)	J ₁ -stat	SCAAR	J ₂ -stat		
66	(0,+1)	0.320	0.142	0.254	2.050	**	
	(0,+2)	0.492	0.178	0.332	2.676	***	
	(0,+3)	-0.071	-0.022	0.212	1.712	*	
	(-1,+3)	0.149	0.042	0.259	2.091	**	
Panel B: Stock price responses for targets							
No. of targets	Event window	CAAR (%)	J ₁ -stat	SCAAR	J ₂ -stat		
107	(0,+1)	3.116	4.886	***	0.923	9.481	***
	(0,+2)	3.632	4.649	***	0.946	9.715	***
	(0,+3)	4.287	4.753	***	1.070	10.998	***
	(-1,+3)	4.849	4.808	***	1.129	11.603	***

Note: ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively.

Many previous studies have been concerned with how value created by an M&A is distributed between the shareholders of the acquirer and the target. Therefore, their samples only use companies that are part of the same M&A. Similarly, we calculate CAAR only for matched samples (Table 7). Table 7 shows that CAARs are not significantly

different from zero in all four event windows for any of the 34 acquirers. SCAARs are significantly positive only at two- and three-day windows. These findings are consistent with those in Table 6, suggesting that a China-Japan M&A tends to increase the share price of the acquirer.

Table 7. Stock price responses to the China-Japan M&As for matched samples

Panel A: Stock price responses for acquirers						
No. of acquirers	Event window	CAAR (%)	J ₁ -stat	SCAAR	J ₂ -stat	
34	(0,+1)	0.542	0.532	0.424	2.455	**
	(0,+2)	0.225	0.180	0.438	2.539	**
	(0,+3)	-0.610	-0.423	0.100	0.579	
	(-1,+3)	-0.424	-0.263	0.238	1.379	
Panel B: Stock price responses for targets						
No. of targets	Event window	CAAR (%)	J ₁ -stat	SCAAR	J ₂ -stat	
35	(0,+1)	5.501	5.929	1.409	8.281	***
	(0,+2)	6.738	5.930	1.492	8.765	***
	(0,+3)	7.301	5.565	1.520	8.929	***
	(-1,+3)	9.505	6.480	1.897	11.149	***

Note: ***, and ** indicate statistical significance at the 1% and 5% levels, respectively.

In addition, both CAAR and SCAAR are significantly positive in all event windows for each of the 35 targets. We note that the results in Table 7 show that in all event windows both CAAR and SCAAR surpass those of the acquirers over the same period. Consequently, China-Japan M&As have a positive impact on the firm value of the target and furthermore, the results imply that the larger part of the value created by M&A goes to the target.

6.1. Univariate analysis

6.1.1 Management improvement hypothesis

We first test the management improvement hypothesis. The relationship between PBR and stock price responses is presented in Table 8, which shows that with one exception (an efficient management in the two-day window), for all the event windows CAARs and SCAARs in cases of both inefficient management and efficient management are significantly positive. In addition, CAARs and SCAARs are greater in cases of inefficient management than in cases of efficient management in both event windows. These results are consistent with those of Dong et al. (2006) and with our hypothesis that targets with inefficient management gain comparatively greater positive economic effects from M&As than do targets with efficient management.

Table 8. Stock price responses and management efficiency for targets

Type of M&A	No. of obs	Event window	CAAR (%)	J ₁ -stat	SCAAR	J ₂ -stat	
Inefficient management	43	(0, +1)	6.634	6.998	***	1.999	12.241 ***
	43	(0, +3)	8.952	6.678	***	2.293	14.039 ***
Efficient management	60	(0, +1)	1.345	1.560		0.384	3.074 ***
	60	(0, +3)	2.109	1.730	*	0.507	4.059 ***

Note: ***, and * indicate statistical significance at the 1% and 10% levels, respectively.

There are two possible reasons for the lesser reaction in share price of 'efficient' targets, compared to that of 'inefficient' ones. First, because net assets are the denominator of PBR, the high PBR is likely to be associated with the high net asset value of the target at the time of the M&A. If PBR is greater than 1, the acquisition cost of assets exceeds that of the actual value and this leaves little scope for imposing

an additional acquisition premium. Because acquisition premiums push up the target's share price (Inoue and Kato 2006), we speculate that the acquisition premium for taking possession of an efficiently run target is smaller than that for taking possession of a target run inefficiently. Another reason may be that when an efficiently run target is subject to an M&A, the management improvement

resulting from the M&A are of little value to the shareholders.

6.1.2 Bailout effect hypothesis

The relationship between stock price responses and the bailout objective is presented in Table 9, showing that both bailout and non-bailout structured M&As have significantly positive CAAR. Among China-Japan M&As based on a bailout purpose, the CAARs

are 4.073% for the two-day window and 5.961% for the four-day window. For non-bailout structured M&As, CAAR is 1.691% at the 1% significance level for the two-day window, and 1.630% at the 10% level for the four-day window. These results indicate that targets experience comparatively greater stock price increases from a bailout structured M&A than a non-bailout structured M&A. The SCAAR results are consistent with the CAAR results.

Table 9. Stock price responses and bailout objective for targets

Type of M&A	No. of obs	Event window	CAAR (%)	J ₁ -stat	SCAAR	J ₂ -stat
Bailout	66	(0, +1)	4.073	4.209 ***	1.013	8.172 ***
	66	(0, +3)	5.961	4.355 ***	1.229	9.915 ***
Non-bailout	39	(0, +1)	1.691	2.875 ***	0.845	5.238 ***
	39	(0, +3)	1.630	1.959 *	0.906	5.619 ***

Note: ***, and * indicate statistical significance at the 1% and 10% levels, respectively.

Our findings are inconsistent with our bailout effect hypothesis and the results of Inoue and Kato (2006), which show that among Japanese domestic M&As, the positive effects on the target's share price are not significant and are less in the case of a bailout M&A than in a non-bailout case. Their results can be interpreted as follows: In inter-Japanese M&As, large-scale restructuring after the acquisition and the associated management improvement costs in bailout-structured M&As can supersede any anticipated management improvement effects. Furthermore, in the case of bailout M&A non-group deals, the target is often purchased at a substantial discount compared to the total market value and this suggests that any upward effects on the share price are but small.

Based on these explanations, we consider two possible reasons for the lack of consensus between the results of the present study and previous research. First, in bailout-structured China-Japan M&As, Chinese acquirers do not subsequently implement restructuring, such as changing the management team, which may bring a feeling of security to the existing management and shareholders¹² and may make the M&As go smoothly, so that management improvement costs are less than those of bailout-structured M&As between Japanese companies.

Second, limited experience with cross-border M&As by a Chinese acquirer may lead to the high purchase price of a Japanese target, resulting in an increase of the target's stock price. This is similar to the experience of Japanese firms that purchased foreign firms at extortionate prices up to the year 2000 (Usui, 2001: p.118). In fact, in terms of

acquisition costs, Chinese firms have been criticized domestically for their naivety and lack of strategy in conducting overseas M&As. For example, if several state-owned enterprises attempt an M&A of the same target company, it ends up becoming a contest and rather than remaining reasonable, the purchase costs become vastly inflated.¹³

6.1.3 M&A structure hypothesis

Table 10 presents the relationship between stock price responses and M&A structure with panels A and B showing the relationship between stock price reactions and M&A structure for acquires and for targets, respectively.

¹² For example, on August 4, 2004, the takeover of Ikegai, a manufacturer of machine tools and industrial machinery, by the Shanghai Electric Group left responsibility for the running of the target firm in the hands of the former management team, and it is held up as an example of M&A success (Niwa, 2010).

¹³ In China, according to a report by a member of the 'State-owned Assets Supervision & Administration Commission of the State Council' on the internet version (the People's Net on October 18, 2010) of the most popular 'People's Daily,' quote: "There are many examples of M&A deals that should have fallen into \$50 - 60 million bracket, which have ended up costing around \$100 million."

Table 10. Stock price responses and M&A structure

Panel A: Stock price responses and M&A structure for acquirers						
M&A structure	No. of obs	Event window	CAAR (%)	J ₁ -stat	SCAAR	J ₂ -stat
Capital participation	29	(0, +1)	0.038	0.030	0.050	0.266
	29	(0, +3)	-0.822	-0.451	-0.169	-0.906
Acquisitions	29	(0, +1)	0.634	0.776	0.568	3.036 ***
	29	(0, +3)	1.202	1.040	0.852	4.558 ***
Other structures	8	(0, +1)	0.205	0.012	-0.142	-0.398
	8	(0, +3)	-1.960	-0.078	-0.725	-2.038
Panel B: Stock price responses and M&A structure for targets						
M&A structure	No. of obs	Event window	CAAR (%)	J ₁ -stat	SCAAR	J ₂ -stat
Capital participation	43	(0, +1)	5.873	5.332 ***	1.628	10.603 ***
	43	(0, +3)	8.371	5.374 ***	1.781	11.602 ***
Acquisitions	46	(0, +1)	1.231	1.363	0.487	3.282 ***
	46	(0, +3)	0.974	0.763	0.474	3.196 ***
Other structures	18	(0, +1)	1.348	0.924	0.352	1.481
	18	(0, +3)	2.997	1.452	0.895	3.773 ***

Note: ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively.

Panel A shows that no CAAR is significantly different from zero. However, SCAAR for the category 'acquisition' is significantly positive at the 1% level. This means that amongst China-Japan M&As, the 'acquisition' category tends to have the largest positive economic impact on the acquirer's share price. This is inconsistent with our M&A structure hypothesis (*Hypothesis 3*). Okabe and Seki (2006) indicate that 'capital participation' M&As have greater post-M&A business efficiency than that of 'acquisition' M&As. However, at the time of M&A execution, such effects may not be factored into the share price. Furthermore, it is conceivable that the reason 'acquisition' M&As have the greatest wealth effects on the acquirer has to do with the level of control. Unlike other M&As, we can speculate that the 'acquisition' structure is the most highly valued by the acquirer's shareholders, as it guarantees control of the target's business. In particular, in the case of China-Japan M&As, it may be that the greatest benefits are the accompanying technology, management know-how, and procurement of sales channels.

Panel B presents that the results for the targets differ from those for the acquirers. The CAARs are significantly positive at the 1% level only for 'capital participation,' while both 'acquisition' and 'capital participation' have significantly positive SCAARs at the 1% level. We also note that both the CAARs and the SCAARs for 'capital participation' are larger than those for 'acquisition.' These results are consistent with our M&A structure hypothesis (*Hypothesis 3*) that 'capital participation' M&As have a greater wealth effect on the targets than do 'acquisition' M&As. As Inoue and Kato (2006) point out, the reason for this may be because the cost of 'capital participation' is lower than that of 'acquisition.' Moreover, because Japanese shareholders may be wary of domestic firms being taken over by foreign

investors, they may evaluate 'acquisition' M&As as less desirable than 'capital participation' M&As by Chinese acquirers, due to yet more fears regarding the technology drain and deterioration in the competitiveness of Japanese targets.¹⁴

6.1.4 Carve-out (subsidiary sale) hypothesis

Table 11 presents the relationship between stock price responses for targets and subsidiary sales showing that neither CAAR nor SCAAR for 'subsidiary sales' is significant in any of the event windows. In contrast, CAAR and SCAAR for the 'others' category are 6.578% and 1.974, respectively, for the two-day window, and 5.593% and 2.183, respectively, for the four-day window. In addition to exceeding the CAAR and SCAAR for 'subsidiary sales,' all are significant at the 1% level. These results are consistent with neither the results of Slovin and Sushka (1998) nor our carve-out hypothesis (*Hypothesis 4*), stating that the target (parent company) gains greater wealth effects from the 'subsidiary sales' than from M&As structured in other ways.

¹⁴ The cautious attitude of Japanese firms regarding M&As by companies in emerging countries is reported in the Teikoku Databank (2010) "Survey on corporate attitudes towards industry reorganization." Of a total of 10,772 firms providing a valid response to the Survey, 8,408, or around 78.1%, said that they thought "the acquisition of Japanese firms by companies based in emerging nations (including business acquisitions and business alliances) would become a threat." In comparison, there are only 1,069 firms, or less than around 10%, which answered that they thought this "would not become a threat." This survey suggests that Japanese firms have severe anxieties on the topic of M&A targeted at Japan by firms in emerging countries.

Table 11. Stock price responses and subsidiary sales for targets

Type of M&A	No. of obs	Event window	CAAR (%)	J ₁ -stat		SCAAR	J ₂ -stat	
Subsidiary sales	56	(0, +1)	-0.036	-0.055		-0.035	-0.260	
	56	(0, +3)	0.012	0.013		0.057	0.426	
Others	51	(0, +1)	6.578	5.793	***	1.974	14.005	***
	51	(0, +3)	8.981	5.593	***	2.183	15.484	***

Note: *** indicates statistical significance at the 1% level.

There are two possible explanations for the lack of wealth effects for Japanese parent firms from the sale of subsidiaries to Chinese acquirers. First, there have been cases where China-Japan M&As are not reported in domestic Japanese newspapers. In our sample, the highest numbers of unreported cases are acquisitions of subsidiaries. Specifically, among the 107 Japanese firms, there is no M&A reporting for a total of 35 firms. In addition, among 56 cases of subsidiary sales, 23 cases are not reported. This is approximately twice as many as the 12 cases that went unreported among 51 other cases (One reason for the lack of reporting about M&As is that name recognition for the target companies themselves is low, and they do not receive much attention, even with an acquisition. In addition, because China-Japan M&As are transacted overseas, recognition of and attention paid to the M&As within Japan are limited).

Second, in many of the cases where Japanese firms sell their overseas subsidiaries to Chinese acquirers, initially these subsidiaries are joint ventures with the Chinese and subsequently, for one reason or another, the Japanese firm withdraws and sells its stake holding in the joint venture to its Chinese counterpart. Although withdrawal may well be based on economic logic, such as a carve-out to concentrate business resources and dispose of non-profitable

departments, it can also be viewed negatively by shareholders who see it as giving up on the Chinese market. Moreover, this may reduce possible positive wealth effects on the parent firm's share price.

This contrasting effect between 'Hong Kong' and 'Mainland' may be because, as discussed in subsection 6.1.3, the development of overseas M&As by mainland Chinese acquirers may have been slower than that of Hong Kong acquirers and thus such mainland acquirers are likely to lack experience in negotiating prices. This may result in paying larger acquisition premiums for overseas M&As, which in turn may have a greater upward impact on the share price of the target.

6.2 Multivariate regression results

Before conducting multivariate regression, we calculate correlation coefficients between variables. The correlation matrix is presented in Table 12, which shows that no large correlation coefficients exist between variables. The results of multiple regression analysis are shown in Table 13. We estimate equation (6) by using all samples and the sample without subsidiary sales to eliminate possible carve-out effects.

Table 12. Pearson correlation matrix

	PBR	Bailout	Method	Manufacturing	Market	District	Equityratio	Asset	ROA
PBR	1.000								
Bailout	0.119	1.000							
Method	-0.119	0.047	1.000						
Manufacturing	-0.097	-0.188	-0.271	1.000					
Market	-0.007	-0.177	-0.166	0.318	1.000				
District	0.030	0.293	0.167	-0.282	-0.114	1.000			
Equityratio	-0.129	-0.262	0.013	0.096	-0.062	-0.140	1.000		
Asset	0.040	-0.302	-0.044	0.223	0.421	-0.163	-0.303	1.000	
ROA	-0.038	-0.332	-0.064	0.187	0.299	-0.201	0.213	0.344	1.000

Table 13. Factors influencing stock price responses to China-Japan M&As

	All samples		Sample without subsidiary sale	
	Coefficient	t-stat	Coefficient	t-stat
Intercept	0.4585	2.0629 **	0.8569	2.0979 **
PBR	-0.0015	-1.5473	-0.0057	-2.2039 **
Bailout	0.0720	1.7330 *	0.0781	0.8882
Method	0.0805	2.1486 **	0.0444	0.5850
Manufacturing	-0.0215	-0.5503	-0.0908	-1.0866
Market	0.0350	0.7902	0.0670	0.8569
District	-0.0709	-1.8937 *	-0.1776	-2.4382 **
Equityratio	0.0051	0.0600	-0.0464	-0.3309
Asset	-0.0412	-2.2181 **	-0.0638	-1.9051 *
ROA	0.0011	2.0775 **	0.0015	1.8839 *
No. of obs		103		48
Adjusted R ²		12.190%		20.298%
S.E. of regression		0.1739		0.2287
Durbin-Watson stat		2.1663		2.2151
F-stat		2.5732 **		2.3299 **

Note: ***, **, and* indicate statistical significance at the 1%, 5%, and 10% levels, respectively.

First, PBR has a negative coefficient for both samples. Although the regression using all samples does not generate a significant coefficient, the regression using the sample without subsidiary sales gives a significant coefficient at the 5% level. The second result is consistent with both our management improvement hypothesis (*Hypothesis 1*) and univariate analysis, stating that the lower the PBR of the target, the greater the wealth effects the target will get from an M&A.

Second, Bailout has a positive coefficient for both samples. Although the regression using the sample without subsidiary sales does not generate a significant coefficient, the regression using all samples gives a significant coefficient at the 10% level. The second result is consistent with both our bailout effect hypothesis (*Hypothesis 2*) and univariate analysis, stating that bailout-structured M&As have a larger wealth impact on the targets than do other M&As.

Third, Method has a positive coefficient for both samples. Although regression using the sample without subsidiary sales does not generate a significant coefficient, the regression using all samples gives a significant coefficient at the 5% level. The second result is consistent with both our M&A structure hypothesis (*Hypothesis 3*) and univariate analysis, stating that Capital Participation M&As have a greater wealth effect on the targets than do other M&A structures, including Acquisition M&As.

Fourth, we could find significant results for neither the manufacturing dummy (Manufacturing)

nor the market dummy (Market), but Manufacturing has a negative coefficient and Market has a positive coefficient. Although the coefficients are not significant, their signs are consistent with our predictions, showing a negative impact of a China-Japan M&A when the target is listed on an emerging stock exchange or runs a manufacturing business.

Fifth, District has significantly negative coefficients at the 10% and 5% levels for the regression using all samples and for the regression using the sample without subsidiary sales, respectively. These results show that the target experiences comparatively greater M&A wealth effects when the acquirer is a mainland Chinese company than when it is based in Hong Kong. This contrasting effect between 'Hong Kong' and 'Mainland' may be because, as discussed in subsection 6.1.3, the development of overseas M&As by mainland Chinese acquirers may have been slower than that of Hong Kong acquirers and, consequently, such mainland acquirers are likely to lack experience in negotiating prices. This may result in paying a larger acquisition premium for an overseas M&A, and this in turn may have a greater upward impact on the share price of the target.

Sixth, among variables controlling for financial conditions, Equity Ratio does not have significant coefficients whose signs are not the same for two regressions. In other words, we do not obtain evidence that a target's capital adequacy ratio is connected to stock price responses to the announcement of China-Japan M&As.

In contrast, Asset and ROA have significant results for both regressions, but the signs of their coefficients are not consistent with our predictions. Asset has significantly negative coefficients at the 5% level for regression using all samples and at the 10% level for regression using the sample without subsidiary sales. These results are not consistent with our prediction, as they indicate that the bigger the target the lower the economic effects it obtains from an M&A. A possible explanation is that the smaller the target, the easier it is to improve business efficiency, resulting in bigger economic effects.

ROA has significantly positive coefficients at the 5% level for regression using all samples and at the 10% level for regression using the sample without subsidiary sales. These results are not consistent with our prediction, as they indicate that the higher the target's profitability, the greater the economic effects it will obtain from an M&A. The possible explanation to support our results may be that the higher the target's profitability, the better its position in M&A negotiations and the higher the acquisition premium it can demand from the acquirer.

7 Sensitivity analysis

To guarantee robustness, we conduct a sensitivity analysis by estimating the following equation for targets, instead of equation (1):

$$R_{it} - R_{ft} = \alpha_i + \beta_i(R_{mt} - R_{ft}) + \gamma_iSMB_t + \delta_iHML_t + \varepsilon_{it} \quad (10)$$

Equation (10) is based on the basic unconditional Fama-French's three-factor model (Fama and French 1993), which comprises the following three factors: the value-weight excess market returns over a risk-free rate (R_{ft}), the size factor spread portfolio (SMB), and the book-to-price ratio factor spread portfolio (HML). We obtain the data for R_{ft} , SMB, and HML from Financial Data Solutions, Inc., which sells the data related to the Japanese version of Fama-French's three-factor model, following Kubota and Takehara (2010). The results are not much different between the two models.

8 Concluding Remarks

We study the growing number of China-Japan M&As in recent years, and analyze the effect of China-Japan M&As on the firm value of the both the acquiring firm and the target firm, based on standard event study methodology. This trend indicates a remarkable change for Japanese firms, which have few experiences in being a target of acquirers from developing countries. As there are relatively few prior studies that examine the economic impact of cross-over M&As by firms from developing countries, we

attempt to investigate whether previously accepted hypotheses are applicable to China-Japan M&As.

By using the 66 listed acquirers and 107 listed targets in China-Japan M&As between 1990 and 2009, we examine how M&A practices and firm characteristics are associated with stock price reactions to the announcement of M&As. We find that as a whole, M&A announcements have a greater positive effect on targets compared with the effect on acquirers. We also observe the following tendency: 1) the lower the management efficiency of the target, the greater stock price reactions to the M&A; 2) the economic effect on targets via a bailout M&A is greater than that of a non-bailout M&A; 3) capital participation imparts a greater economic effect on the target than that of other forms of M&A; and 4) targets gains fewer economic benefits from the sale of subsidiaries than from other forms of M&A. The first finding is consistent with hypotheses previously accepted by studies on M&As between firms located in developed countries, while the other three findings are not.

Other findings include: 5) M&As by acquires located in mainland China exert a greater economic effect on targets than that of acquirers located in Hong Kong; 6) the larger the size of the target, the lesser the stock price reactions to an M&A of that firm; and 7) the greater the profitability of the target, the greater the market reactions to the M&A of that firm. Our results are robust as the sensitivity analysis using the Fama-French's three-factor model provides similar results to our main results.

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