EFFECTS OF OWNERSHIP STRUCTURE, MOTIVES AND PREMIUMS PAID ON BIDDING FIRMS' PERFORMANCE

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by

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KESAN STRUKTUR HAKMILIK, MOTIF DAN PEMBAYARAN PREMIUM KE ATAS PRESTASI FIRMA PEMBIDA

ABSTRAK

Secara umumnya literatur mengenai pengambilan korporat menyimpulkan bahawa pembida rugi atau tidak untung di sekitar pengumuman pengambilalihan. Walaupun begitu, statistik telah menunjukkan bahawa pengambilan korporat masih menjadi suatu strategi yang popular oleh firma-firma untuk pertumbuhan. Kajian ini bertujuan mengisikan jurang persoalan ini dengan menggunakan pendekatan kaedah berbeza dan pemilihan sampel yang lebih ketat dalam menangani isu-isu prestasi di atas. Kajian ini juga bertujuan memeriksa motif pengambilalihan di Malaysia dan sama ada pemilikan saham oleh pemegang saham besar dan identiti mereka akan mengurangkan atau memburukkan lagi masalah agensi.

Kajian ini menggunakan 63 pengambilalihan besar oleh syarikat-syarikat senarai awam di Malaysia dari 1990 hingga 1999. Data prestasi merangkumi tiga tahun sebelum dan empat tahun selepas peristiwa pengambilalihan. Hasil keputusan penganalisaan menunjukkan bahawa motivasi pengambilalihan firma sasaran oleh firm pembida ialah untuk meningkatkan prestasi firma pembida supaya prestasi firma pembida adalah setanding dengan firma dalam industri yang sama. Kebanyakan sasaran pengambilalihan adalah dari jenis industri yang berkaitan dengan industri pembida supaya mereka dapat menikmati sinergi operasi. Firma sasaran yang berprestasi tinggi juga diperolehi supaya dapat mengukuhkan pendapatan pembida. Ini adalah berlainan daripada pengambilan korporat di Barat di mana pengambilalihan telah dilihat sebagai mendisplinkan pengurus firma sasaran. Memandangkan pertumbuhan ekonomi yang cepat dalam 1990an, sinergi kewangan berkecenderungan berlaku dalam kes-kes pengambilalihan yang telah membantu firma pembida dalam menubuhkan pasaran dalaman yang membolehkannya mengagih modal dengan lebih efisien.

Walaupun begitu, motif untuk mendapat sinergi seperti yang dicadangkan oleh teori pengambilalihan tidak dapat menjelaskan variasi dalam prestasi firma pembida selepas peristiwa pengambilalihan. Keupayaan firma mendapat keuntungan sinergi daripada pengambilalihan adalah bergantung kepada penumpuan saham oleh pemegang saham terbesar dan identiti pemegang saham terbesar itu. Walau bagaimanapun, kesan penumpuan hak milik saham ke atas prestasi firma pembida didapati tidak monotonik; pada tahap yang rendah, ia akan meningkatkan prestasi firma pembida tetapi pada tahap yang tinggi (>53 peratus), ia akan mengakibatkan kesan yang sebaliknya ke atas prestasi firma pembida. Penemuan ini telah memanjangkan teori agensi yang menyatakan peningkatan tumpuan saham oleh pengurus akan menigkatkan prestasi firma kerana keselarasan minat antara pengurus dan pemegang saham biasa.

Kajian ini juga mendapati hubungan antara pembayaran premium dan prestasi selepas pengambilalihan adalah bercorak lengkungan. Penemuan ini telah memberi bukti empirikal kepada hipotesis hubris iaitu pembayaran premium yang terlalu tinggi akan mengakibatkan pengambilalihan gagal. Penemuan kajian ini juga menunjukkan bahawa penumpuan hak milik saham dan pemilikan saham oleh keluarga dapat mengurangkan masalah agensi dalam kes-kes melibatkan pengambilalihan.

EFFECTS OF OWNERSHIP STRUCTURE, MOTIVES AND PREMIUMS PAID ON BIDDING FIRMS' PERFORMANCE

ABSTRACT

Generally literature on take-overs highlight that bidders lose or do not gain upon the announcement of a take-over. Despite the negative empirical findings, take-over activities are still a major corporate manoeuvre for growth as can be seen from the increasing trend in the statistics. This study intends to fill the gap by using alternative approaches and more stringent sample selection criteria in addressing the above performance issue. It also seeks to determine the effect of take-over motives in Malaysia and whether ownership by large shareholders and their identity reduce or exacerbate the agency problem in cases of Malaysian take-overs.

Using 63 large take-overs by Malaysian public listed firms from 1990 to 1999, with three pre and four post-take-over years of observations, the findings indicate that corporate take-overs in Malaysia were driven by under-performance of bidders as compared to their matched counterparts. More related businesses were acquired by bidders as suggested by the operational synergy argument. Most of the take-overs were sought to enhance the earning base of the bidders by acquiring well-performing targets rather than playing the disciplinary role for managerial synergy. Given the fast economic growth in the 1990s, financial synergy mostly incurred in the cases of take-overs that have helped in the creation of internal markets that allowed for allocation of capital more efficiently.

However, the implied motives for synergies as suggested by take-over theory (Megginson and Smart, 2004) are found to have no relationship with the post-take-over

performance. The potential synergistic gain is contingent on the ownership stakes of the largest shareholders and the identity of the largest shareholders in Malaysia. However, the effect of concentrated shareholding on performance is not monotonic, it enhances performance at the lower level of ownership but causes adverse impact at the higher level of ownership (>53 percent). This has extended the current knowledge in agency theory (Jensen and Meckling, 1976) that increase in ownership stakes held by managers would align the interests of the managers to that of the shareholders.

This study also finds evidence of curvilinear relationship between the premiums paid and post-take-over performance. This has provided empirical evidence to hubris hypothesis (Roll, 1986) that excessive premiums paid caused the business combination to fail. The evidence from this study also suggests that firms can benefit from family and concentrated ownership by reducing the agency problem associated with take-overs.

CHAPTER ONE

INTRODUCTION

1.0 Background of the Study

Business combinations are a norm in a free open market. The terms such as take-overs, mergers, and acquisitions (M&A) mean business combination of target and bidder, and are often used interchangeably in the literature. These activities represent massive reallocation of resources within an economy. The objectives are to channel the corporate assets towards their best possible use. It also enables firms to grow in a short period. These popular forms of business investments gained popularity in the business world with no exception to Malaysia, especially in the 1990s.

Using the SDC Platinum of Thomson Financial Securities data of Worldwide Mergers and Acquisitions Database, Metwalli and Tang (2002) reported that Malaysia accounted for 41 percent of the total deals and 38 percent of the M&A transaction value of target firms in ASEAN from 1990 to 2000. M&A transactions between local firms accounted for 74 percent of all the M&A transactions and about 89 percent of the transactions were done by asset acquisitions. By compiling the announcement records from Jan 1991-Jan 2000 in the Investors Digest, this study found that there were about 781 targets announced in the 1990s. This figure did not include asset acquisition transactions. However, based on our scrutiny of the annual reports and announcement files, we found that only about 60 percent of the targets announced which involved offers to acquire all or part of the voting shares were successfully taken over by the bidders.

The Malaysian take-over figures in the 1990s doubled to that of the 1970s and 1980s combined due to the rapid expansion of the Malaysian capital market. The total value of take-over activities was over RM40 billion in 2002 (PricewaterhouseCoopers, 2004) and RM59 billion in 2005 (Sidhu, 2006) as compared to an estimated RM10 billion in 1990 (Jayasankaran, 1990). The growth of the Malaysian take-overs was catalysed by a number of factors including rapid globalisation of trade and services, securing brands and technology by corporations in order to maintain their competitiveness. It was also mediated by the fiscal and monetary policies that controlled inflation and unemployment while maintaining an average growth rate of five percent per year. However, compared to the post-crisis period, the government-led initiative to consolidate some industries such as telecommunications, banking and finance to ensure domestic and international competitiveness was not that prevalent in the 1990s.

Manne (1965) highlighted that the advantages of take-overs in an economy include a lessening of wasteful bankruptcy proceedings, more efficient management of corporations, protection for non-controlling corporate investors, increased mobility of capital, and generally more efficient allocation of resources. A wave of take-overs in recent years has drawn widespread attention, however little attention has been paid to the consequences of take-overs. While the motives behind these take-overs received only modest attention, these factors ultimately determined whether a merger or acquisition was attempted. At the firm level, management of bidding companies often highlighted that the take-over strategy was to maximise the wealth of their shareholders. Gaughan (1994, 2002) and Megginson and Smart (2004) highlighted that in the 1990s, expected synergies were regarded as the primary motives for take-overs in order to improve efficiency and achieve better corporate performance. In the process, the acquirer often paid a premium over the market value of the targets’ assets and technologies for the expected synergies if the two firms were combined. The premiums paid also represented the value of the required improved performance by the bidding firms.

However, past studies have showed that shareholders of acquiring firms were no better off or even lose upon the announcements of the business combinations. In the long run, bidders lost even more as highlighted by Agrawal, Jaffe and Mandelker (1992), Franks and Harris (1989). However, conflicting results were found in accounting-based studies in assessing the post-take-over performance. Ravenscraft and Scherer (1989) and Ghosh (2001) who examined earnings performance concluded that merged firms had no operating improvement whereas Healy, Palepu, and Krishna (1992), Abdul Rahman and Limmack (2004) and Powell and Stark (2005) found positive cash flow returns as a result of the business combination.

In addition to addressing the above unresolved performance issue, this study seeks to investigate the possible factors that may cause the variations in post-take-over performance of the bidding firms by looking into three groups of variables namely ownership structure, take-over motives, and premiums paid. It focuses on take-over cases as the bidder would be able to take-over the control of the target firm.

Recent literature widely supports that ownership structure has important implications for governance and performance. (McConnell & Servaes, 1990; Morck, Shleifer, & Vishny, 1988; Sudarsanam, Holl, & Salami, 1996). Most studies on take-overs in developed countries highlighted agency conflicts between shareholders and their managers whereby managers, being propertyless, try to maximise their own utilities rather than the shareholders' (McConnell & Servaes, 1990; Morck, Shleifer, & Vishny, 1988). In contrast to the diffused ownership structure found in the US, highly concentrated ownership especially in the hands of families is a characteristic of many East Asian corporations. The concentration of ownership, as highlighted by Jensen and

Meckling (1976), would be beneficial to corporations as it allows for greater monitoring of managers. It also reduces transaction costs in negotiating and enforcing corporate contracts with various stakeholders. This is supported by Morck, Shleifer and Vishny (1988) who noted that the absence of separation between ownership and control reduces conflicts of interest and this increases shareholder value.

However, the role of the controlling parties to act in the best interest of minority shareholders is still debatable. This is due to the reasons that minority shareholders in developing countries such as Malaysia have long adopted a passive role and as a result of that their rights have often been ignored. La Porta, Lopez-De-Silanes, and Shleifer (1999) and Claessens, Djankov, and Xu (2000) contended that the agency problem in Asian countries was intensified by the high concentration of ownership in the hands of family members or politically linked business groups. They argued that the primary issue for large corporations in East Asia is limiting expropriation of minority shareholders by controlling shareholders, rather than restricting empire building by unaccountable managers. In other words, the main principal-agent problem in East Asia is not the conflict of interest between owners and managers, but between the majority and minority shareholders. This was echoed in studies by Lemmon and Lins (2003), Claessens et al (2000), and Claessens, Djankov, Fan, and Lang (1999) that have linked the 1997/98 Asian Financial crisis to the governance structure of corporations in the countries involved. These studies have highlighted that the entrenched manager or the controlling shareholders in firms with high concentration of ownership tend to engage in non-value-maximizing activities for private gains. The incidences of related-party transactions, questionable decision making, asset shifting, as well as conflicts-of-interest transactions without proper disclosure by directors were areas identified by the Securities Commission that caused the vulnerabilities of listed companies in the 1997/98 crisis and thus needed strengthening in terms of corporate governance. (Securities Commision, 2004, p.171).

Johnson, La Porta, Lopez-de-Silanes, and Shleifer (2000) highlighted the "tunnelling" effect by the controlling party, which reflects that the controlling shareholders have strong incentive to transfer out resources from the firm for their own private benefits at the expense of minority shareholders. This is often done through related-party transaction where the directors or the substantial shareholders of the companies buying over the company or assets owned by them at a very high premium. Besides, if the controlling parties pursue their own self-interest in order to reduce their personal portfolio risk, or control over more companies to get greater perquisites and power, the more likely that they will pay a higher premium in order for the target shareholders to relinquish their shares.

Although the willingness of the bidders to pay for a premium signals that the combined firms will be worth more than the two firms operating as separate entities, Roll (1986) and Sirower (1997) contended that the higher the premiums, the greater is the value destruction from the acquisition strategy. This is because the acquirer is expected not only to meet the existing performance levels but also to meet the even higher levels of performance implied by the acquisition premium. Thus, the motive for take-over must be driven by synergies that could translate into performance gains beyond those that were already expected. If the controlling parties act in their self-interest, it is likely that the take-over will fail. Hence, the take-over motives, namely operational, managerial or financial, are to infer any possible sources of value creation or possible agency conflicts that could have a profound impact on the combined firms in this study.

As discussed above, a clear understanding of the effects of concentrated ownership and the controlling owner's identity on corporate decision making, which in turn may have an impact on their performance remains limited. Suto (2003) and Wiwattanakantang (2001) suggested that further examination on the net effects of concentrated ownership and family businesses in emerging market is needed in order to improve corporate management. Thus, the focus of this study is on how the different constituencies in the ownership structure of corporation, their motives for take-overs and the bid premiums paid could interact with each other and affect the performance of the acquiring firms. This study also aims to draw a conclusion whether concentrated and family-type ownership would mitigate agency problems or exacerbate the conflicts.

The determinants of premiums paid are also being examined in this study as there is a lack of literature on it especially in the Malaysian context. This will provide a more insightful background of corporate take-over in Malaysia. Given many similarities of corporate governance issues in East Asian corporations especially the concentration of ownership in the hand of large shareholders and families, this research may thus have valuable lessons for other countries as well.

This study is an extension to the previous take-over studies done in the Malaysian context by including agency, efficiency and valuation theory in the analysis. Mat Nor and Mohd Zin (1996), Ali (1998) and Abdul Rahman (2000) used the Malaysian take-over data from 1977 – 1989, 1980 - 1993, and 1988 - 1992 respectively. Various take-over characteristics had been examined by them, however, they had not looked into the ownership structure of the bidders, the premiums paid and their motives for take-overs in explaining the post-take-over performance. Moreover, most of the data previously used were from the 1980s; however the scenarios in the 1990s were very much different from those in the 1980s. For instance, Malaysian take-overs in the 1980s were mainly driven by political economic factors (Gomez & Jomo, 1997; Searle, 1999). In the 1980s and early 90s, pressure on the political leadership to transfer the assets from state to private sector vis-à-vis redistribution of wealth under the NEP (National Economic Policy) had given rise to many politically linked and conglomerate style of take-overs (Serle, 1999, p.105). One example is the largest take-over of Fleet Group by Renong in late 1980s, which saw the effective control of eight publicly listed companies and unlisted subsidiaries. While for the Chinese community, MPHB (Multi Purpose Holding Berhad) was set up by MCA (Malaysian Chinese Association) to protect the commercial life of the Chinese community in view of the constraints posed by NEP had taken over Guthrie, Magnum, Dunlop and others, which was claimed as strategic investments by their leaders at that time.

Generally, take-overs in the 1980s were more of conglomerate oriented as highlighted in Ali (1998) whereby out of the 37 bidders, 28 pursued conglomerate diversification. In the 1990s, corporate take-overs were more focused, for instance out of the 136 take-overs in this study, about half of the targets or 73 of them were from businesses related to the current business of the bidders. This is an indication that the 1990s take-overs were more synergistic driven as compared to the 1980s (Gaughan, 2002). Generally, long-run returns were significantly related to the change in the focus of business (Megginson, Morgan & Nail, 2004). With the expansion of the capital market from 250 companies (valued at RM43.1 billion) listed on the KLSE in 1980 to 795 companies (valued at RM444.4 billion) in 2000 plus the impact of the 1997 financial crisis in the 1990s, the take-over characteristics are expected to be very much different from the 1980s.

1.1 Problem Statement

Performance measurement is one of the most important issues concerning the survival of firms and to a large extent to the competitiveness of a nation. Therefore, if the allocation of capital is made to poorly considered targets, it may eventually cause the market to be less efficient and eventually may lead to low levels of trust and stymie growth.

It has been consistently reported that the majority of the bidders lose or do not gain upon the announcement of a take-over. In Malaysia, similar findings were found by Mat Nor and Mohd Zin (1996) and Ali (1998). The average negative reaction implies that investors expect future performance of the combined firms would not be improved. However, using the accounting-based studies, Healy, Palepu, and Ruback (1992), Abdul Rahman (2004) and Powell and Stark (2005) found positive cash flow returns as a result of mergers. Ravenscraft and Scherer (1989) and Ghosh (2001) who examined earnings performance, on the other hand have concluded that merged firms have no operating improvement. Despite the negative and conflicting empirical findings, take-over activities are still a major corporate manoeuvre for growth as can be seen from the survey by Metwali and Tang (2002). In this study, two alternative performance measures namely the accounting-based measure and the market-based measure were used. The control adjusted accounting-based measure was used to capture effects of actual changes in fundamental value while the control adjusted market-based measure was used to capture the value perceived by the investors. Thus, these two alternative measures were used to check the consistency and robustness of the method used in assessing the post-take-over performance.

As highlighted earlier, recent literature widely supports that ownership structure has important implications for governance and performance. Most studies on take-overs in developed countries highlighted agency conflicts between shareholders and their managers where the share ownership in the corporations were dispersed. Malaysian corporations, on the other hand, displayed a very high concentration of share ownership that was controlled by the dominant owners. However, the role of the controlling parties to act in the best interest of the minority shareholders is still debatable. Controlling shareholders may align their interests to that of the minority shareholders or act in their self-interest such as tunnelling out corporate resources (Johnson et al, 2000) in related-party transaction. They may also pay a higher premium for a target so that they could gain more perquisite consumptions for controlling a larger empire. As such, Roll (1986) and Sirower (1997) argued that the higher the premium, the greater is the value destruction from the acquisition strategy. A clear understanding of the effects of concentrated ownership and the identity of the dominant owners on corporate decision making, which in turn may have an impact on corporate performance, is still limited. Instead of focusing on the indirect relationship between ownership and performance (Lemmon & Lins, 2003; Thomsen & Petersen, 2000; Demsetz & Lehn, 1985), this study aims to attain specific evidence of the behaviour of the controlling shareholders, namely their discretion over corporate decisions on motives for take-overs and the levels of premiums paid. The study also aims to assess the interaction effect between motives for take-overs, premiums paid and ownership structure on post-take-over performance. Finally, it also seeks to draw a conclusion whether concentrated and family-type ownership would reduce agency problems or aggravate the conflicts.

1.2 Research Questions

Research questions below are raised to address the research problems above.

(i) Do operating performance and firm value improve after a take-over?

(ii) What were the motives for firms to engage in take-overs in Malaysia?

(iii) Does ownership structure (namely ownership concentration and the identity of the dominant owners) mitigate the agency problem or exacerbate it? Does ownership structure lead to the expropriation of minority shareholders?

(iv) What is the relationship between premiums paid and take-over performance?

(v) Does the identity of dominant owners (namely family ownership) influence the levels of premiums paid and performance?

(vi) What are the determinants of premiums paid? Does ownership structure moderate the relationship between take-over motives and levels of premium paid?

1.3 Research Objectives

The need for information on the relationship between take-over motives, structure of ownership, bid premiums and the performance of the acquiring firms in Malaysia dictates the objectives of this investigation, which are as follows:

(i) to determine the post-take-over operating performance and firm value of the bidding firm

(ii) to determine the take-over motives in Malaysia

(iii) to determine the effects of take-over motives, ownership structure, and premiums paid on the post-take-over performance of the acquiring companies.

(iv) to identify the determinants of premiums paid.

1.4 Significance of the Study

Given the potential impact of corporate take-overs, knowledge on ownership structure, the motives for take-overs, determinants of premiums paid and their consequences are important for a host of decision makers as follows:

(i) **Investors** - especially the non-controlling shareholders and other retail investors who supply funds in exchange for risk capital, would be interested to know the impact of the take-overs. This study provides knowledge on the determinants of post take-over performance. Investors may also use the models to price and evaluate tender offers and formulate appropriate investment strategies.

(ii) **Potential bidders** who are interested in pursuing external growth strategy would benefit from insights on the motives for take-overs and their consequences under different ownership structure and the levels of premiums paid. This knowledge would assist managers to make more informed managerial decisions, increase their bargaining power and thus increase the likelihood of more efficient take-overs.

(iii) **Government policy makers and regulatory agencies** such as Bank Negara Malaysia (BNM), Securities Commission (SC), and others would be interested in information on take-overs, and distribution of ownership for planning and regulating economic development. This thesis provides insight on the issue, and effects of large shareholdings as well as pricing behaviour of the corporate control market. Thus, it would help the authorities to revisit the adequacy of the current listing requirements especially with regard to ownership distribution and the Malaysian Code on Take-overs and Mergers to enhance the Malaysian equity market as an attractive avenue for investment.

(iv) **Researchers** would benefit from this study as the findings of this study relates to managerial theories such as agency conflicts and the performance of firms in a developing country such as Malaysia. The theoretical contribution of this study includes advancing the knowledge of the agency theory and efficiency theory in relation to M&A in the context of a developing country. Specifically, it provides further evidence in explaining the conflict of interests (or alignment of interest) between controlling shareholders and minority shareholders in developing countries. The unique institutional background of Malaysia provides an alternative view on the effect of concentrated corporate ownership and family owned firms in corporations involved in take-overs. It also offers a model for bid premium valuation, and lastly contributes to the knowledge in efficiency theory (Mueller, 1995; Trautwein, 1990) by operationalising the motives for take-overs in Malaysia.

1.5 Organisation of the Thesis

Chapter one of the thesis describes the background, problem statement, research questions, objectives of the study, significance of the study and organisation of the thesis. Chapter two describes the regulatory framework and history of M&A in Malaysia. Chapter three reviews literature and develops respective hypotheses. Chapter four discusses the sample and methodology used, variable definitions and a priori expectation on the models used. Analyses of results are presented in Chapter five. Chapter six discusses, concludes, and highlights the contribution and limitations of the study and suggestions for future research.

CHAPTER TWO

INSTITUTIONAL BACKGROUND

2.0 Introduction

This section discusses the development of the Malaysian equity and corporate control market, and the regulatory framework that governs take-over activities. The formation of concentrated ownership and control in the corporate sector, investor characteristics, and shareholder protection are also highlighted to enhance the understanding of the institutional background of Malaysia and the dynamic aspect of the Malaysian corporate take-over activities.

2.1 Development of the Malaysian Equity Market

Although relatively new in the world capital market, the expansion of the Malaysian capital market was spectacular. In the early days (1900s), most companies with shares traded were companies founded by the British, encouraged by the boom in rubber and tin industries. These companies included Guthrie & Co Ltd, Fraser and Neave Co Ltd, Malakoff Plantation Co Ltd, and Sime Darby & Co Ltd (Securities Commission [SC], 2004). The shares were traded informally at popular meeting places such as colonial clubs, shop houses, and coffee shops. In 1930, the first formal organisation of stockbrokers, the Singapore Stockbrokers' Association was established. In 1957, following the independence of Malaya, the Central Bank, Capital Issue Committee and stock exchange were established to develop the equity market. The aim was to use the equity market as a corner stone for economic development. (SC, 2004, p.7).

The inception of the Kuala Lumpur Stock Exchange or KLSE (now Bursa Malaysia) was in 1973. The name was changed from the Malayan Stock Exchange (1960) to Stock Exchange of Malaysia and Singapore following the secession of Singapore from Malaysia in 1965. In 1973, with the termination of currency interchangeability between Malaysia and Singapore, the Stock Exchange of Malaysia and Singapore was officially separated into the Kuala Lumpur Stock Exchange and Singapore Stock Exchange. Since then, the number of companies listed on the KLSE grew from 262 in 1970s to 795 in year 2000. As of August 2005 it recorded 1006 companies listed with 640 companies on the main board, 272 on the second board (established in 1989), and 94 on the MESDAQ (Malaysian Exchange of Securities Dealing and Automated Quotation).

After India and Hong Kong, the spectacular growth of the Malaysian capital markets has made it ranked the third largest number of listed companies among countries outside the Organisation for Economic Co-operation and Development (OECD). It was also ranked the largest stock market in Southeast Asia in terms of market value in 2003 (SC, 2004, p.257). The market valuation was estimated at RM43.1 billion in the 1980s and grew to RM706.36 billion in August 2005. In terms of the value of funds raised in the capital market, it was a mere 4 percent of the gross domestic product (GDP) in 1993. The amount grew to 13 percent in 2003. The decade also saw the amount of funds raised in the capital market growing by 34 percent, compared to bank lending growth of only 12 percent. Table 2.1 provides the summary statistics of the growth of Bursa Malaysia since its inception till 2005.

During the 1990s, the equity market experienced two extreme conditions: the super bull-run in 1993-1994 and the financial crisis in 1997-1998. The growth in the

Table 2. 1

Number of Companies Listed at the Bursa Malaysia from 1973-2005

Total Number of Listed Companies				
Year	Main Board	Second Board	MESDAQ	TOTAL
2005	646	268	107	1021
2004	622	278	63	963
2003	598	276	32	906
2002	562	294	12	868
2001	520	292	-	812
2000	498	297	-	795
1999	474	283	-	757
1998	454	282	-	736
1997	444	264	-	708
1996	413	208	-	621
1995	369	160	-	529
1994	347	131	-	478
1993	329	84	-	413
1992	317	52	-	369
1991	292	32	-	324
1990	271	14	-	285
1989	305	2	-	307
1988	295	-	-	295
1987	291	-	-	291
1986	288	-	-	288
1985	284	-	-	284
1984	282	-	-	282
1983	271	-	-	271

1982	261	-	-	261
1981	253	-	-	253
1980	250	-	-	250
1979	253	-	-	253
1978	253	-	-	253
1977	256	-	-	256
1976	264	-	-	264
1975	268	-	-	268
1974	264	-	-	264
1973	262	-	-	262

Note. Retrieved on August 31, 2005, from http://www.bursamalaysia.com

Malaysian capital market was mainly due to the inflow of foreign portfolio into the country, followed by the incorporation of Malaysian stocks into a number of global benchmark indices. It is also stimulated by the sound economic policies implemented by the Malaysian government such as lower interest rates compared to other countries in the regions, and attractive corporate earnings.

In order to encourage small and medium enterprises (SMEs) to raise capital in the market, the Second Board was introduced in 1988 to facilitate the listing of these small and medium enterprises. These SME were usually from the industries that had shown good track record in earnings and had attractive growth prospects. MESDAQ was set up in 1997 to provide high growth and technology-based companies with little or no proven track record to seek financing in the capital market. The setting up of the Second Board and MESDAQ has facilitated an influx of comparatively smaller, family-owned companies seeking listing status in equity market.

2.2 Development of the Corporate Control Market

The take-over activities also followed the growth of the capital market. In the 1970s, there were only 40 take-overs announced as shown in Table 2.2. The number has increased by about ten times to 394 in the 1980s and further rose to 781 in the 1990s. Take-over activities were especially concentrated at the beginning of the 1990s when the equity market experienced the super bull run.

Table 2. 2

Number of Take-overs from 1970s to 1990s

	1970s	1980s	1990s
Announcements	40	394	781
Confirmed take-overs			
Targets from non-public listed companies	10	132	376
Targets from public listed firms	2	29	62
Targets from foreign firms	4	25	28
Total	16	186	466

Note. Compiled from Investors Digests (various issues), KLSE Announcement files, and Annual Companies Handbook (various issues).

The value of take-over transaction in 1990 was estimated at about RM10 billion (Jayasankaran, 1990). However, this value has increased to about RM50 billion in 2003 (PricewaterhouseCooper,2004) and RM 60 billion (Sidhu, 2006) in 2005. A study by Metwalli and Tang (2002) reported that the Malaysian M&A transaction value including asset acquisitions between 1990-2000 was at USD124.8 billion with 2430 deals materialised. Some of these transactions were financed by cash but the majority were financed by equity.

The exponential growth of M&A activities in the 1990s was due to a number of factors, for instance, as mentioned in Chapter one, rapid globalisation of trade and services and the expansion of the Malaysian equity market have induced corporations pursuing growth strategies by acquiring brands and technology (PricewaterhouseCooper, 2004). This is the fastest and less risky mode of entering into a new business in order to gain technology and market share.

In addition, the setting up of the Second Board, which allowed for the listing of relatively smaller companies, had aggravated the take-over activities whereby these companies were targeted for backdoor listing or a reverse take-over. A reverse take-over or back-door listing involved the acquisition of an unlisted company by a listed company which results in the owners of the unlisted company becoming the new controlling shareholders of the listed company (SC, 2004, p.65).

The depletion of tin in the mining sector and low commodity prices, had also contributed to the increase in take-over activities from particularly, commodity based corporations. Take-over activities acted as a means to improve the earning base of these companies. As such in the 1980s, many take-overs were directed to unrelated sectors. For instance, Kampung Lanjut Tin Dredging Bhd. has changed its core business in tin mining into property development, investment, and financial services. This gave the company the features of a conglomerate structure group.

The growth of the conglomerate groups in the Malaysian economy was pronounced. They operated a wide range of across a diversified range of activities within a sector as well as across many sectors in the economy. For example, the business of CMS, a conglomerate group based in Sarawak involved business from plantation, mining, manufacturing, trading and services to construction and property development. The effect of conglomeration spilled over to take-over activities, many multiple bids were announced in a single announcement (Appendix 2). For instance, on 25 October 1994, Advance Synergy Bhd announced the acquisition of the United Merchant Bank, Cherating Holiday Villa Sdn. Bhd., Langkawi Holiday Villa Sdn. Bhd., Mayor Hotel Bhd, and Plastic Centre Sdn. Bhd. A series of acquisitions were also witnessed during the period; for example Autral Amalgamated, announced the acquisitions of the Malaya Ceramic Industries Sdn. Bhd. in 1990, Danau Kota Development in 1991, Chong Fui Shipping and Forwarding Sdn. Bhd., Mandarin Tours and Travel Sdn. Bhd., and Likas View Sdn. Bhd. in 1994.

Claessens, Djankov, Fan, and Lang (2003) highlighted that the extensive diversification of Malaysian firms in the 1990s resulted in misallocation of capital investment as capital was channelled towards less profitable and more risky business segments. They revealed that out of 531 Malaysian firms surveyed from the period of 1991-1996 from the Worldscope database, 70 percent were involved in multi-segment businesses as they operated more than one two-digit SIC code industries. Firms were classified as single-segment if at least 90 percent of their total sales were derived from one two-digit SIC code segment, otherwise they were classified as multi-segment firms. Malaysia ranked second after Singapore, which recorded 72 percent. The average figure was 65 percent for all the nine countries surveyed.

In terms of the successful rate of take-overs, it was quite low at about 40 percent in the 1970s. It increased to about 60 percent in the 1990s. Many deals were cancelled in the early days mainly due to weak law and enforcement on take-over announcements. Very often little financial information was disclosed upon an announcement of a take-over. As most Malaysian investors were retail investors who were not sophisticated, upon announcement of a take-over, it would lead to the escalation of share price movement. However, when a deal was called off share prices would experience a sharp decline. The unhealthy speculative activity that surrounded the announcement of a take-over had lead to the cashing out of the majority shareholders at the expense of the minority shareholders. As a result, this had lead to the revision of Malaysian Code of Takeover and Mergers (the Code) whereby more stringent rules on take-over were imposed (SC, 1998).

2.3 Regulatory Framework

Malaysia adopts the English common law in its legal system. The primary Act of Parliament governing companies is the Companies Act, 1965. The Security Industry Act, 1983 and Securities Commission Act, 1993 are two other statutes that directly govern the public listed companies. Other relevant laws include the Kuala Lumpur Stock Exchange (Now Bursa Malaysia) Rules and the Foreign Investment Committee Guidelines.

The regulatory authorities include the Companies Commission of Malaysia (CCM, formerly Registrar of Companies), The Bursa Malaysia (formerly KLSE), and the Securities Commission (SC). The principal duty of CCM is to ensure companies, whether they are private or public companies, comply with the provisions of the Companies Act and the subsidiary legislation made thereunder. The Bursa Malaysia, on the other hand, governs the conduct of public listed companies and enforces listing and disclosure requirements. The SC regulates the affair of the listed companies which include a wide range of power such as regulating take-overs, mergers and acquisition of companies, ensures proper conduct by the companies and their officers, and so on. The purpose of the SC was to promote the development of the capital market and to take responsibility for streamlining the regulations of the securities market, speeding up the processing and approval of corporate transaction and to protect the interest of investors (SC, 2004, p.49).

Prior to 1993, the regulatory body that governed take-overs activities was the Panel on Take-overs and Mergers (the Panel). Pursuant to section 179 of the Companies Act, the Panel administered the Code on Take-overs and Mergers 1987 and issued various practice notes. The practice notes were issued from time to time to serve as a guide to the application of the Code. The 1987 Code consists of three parts: part one dealt with definitions, part two comprised of 14 general principles and part three contained 40 rules.

The establishment of Securities Commission (SC) in 1993 saw the formulation of the Securities Commission Act (SCA), 1993. Take-overs and mergers are now governed by the provision contained in part IV Division 2 of the Securities Commission (Amendment) Act 1995. A review of the 1987 Code was made in 1998 as stricter liabilities and obligations on market participant were deemed important to ensure the adequate protection of minority shareholders' right. The current Code in use is the Malaysian Code on Take-overs and Mergers, 1998. The Code applies to the take-over of all public companies and private limited companies which satisfies certain conditions. First, pursuant to Practice Note 1.2 of the Code, it applies to a take-over of a private company if it has shareholders' funds of a paid up capital of RM10 million (while in the previous Code it was RM5 million) or more based on the latest audited accounts or for a purchase consideration of more than RM20 million (RM10 million in the previous Code). The second condition imposed under the Code is the acquisition of shares giving rise to the control of over 33 percent of the voting rights of companies.

The principles of the Malaysian Code on Take-overs and Mergers (1998) is in accordance with the provision of subsection 33A(3) of the Securities Commission Act.

It stipulates that the acquisition of voting shares shall take place in an efficient, competitive and informed market. It shall have considered the objectives as stated in subsection 33A (5) of the Act. This is a revision to the Malaysian Code on Take-overs and Mergers 1987, previously administered by the Panel on Take-overs and Mergers, and the Capital Issues Committee's Guidelines for the New Issue of Securities and the Valuation of Public Listed Companies. The Code on Take-overs and Mergers 1998, which is currently adhered to, consists of nine parts with 42 codes, three schedules and various practice notes. Part I of the Code deals with definitions and general principles, Parts II and III outline the application of mandatory and partial offers, Parts IV, V and VI delineate announcement, terms and timing of offers, Parts VII and VIII draw obligation of offeror and offeree in relation to offer and Part IX deals with general issues such as false and misleading information, and others.

With the introduction of the new Code, the SC becomes the sole authority and regulator for matters relating to take-overs and mergers. The emphasis now is on the adequate disclosure of information to all parties involved in take-over and merger exercises. This is to ensure that all take-overs, mergers and compulsory acquisitions take place in a competitive, informed and efficient market. Strict criminal liability was also introduced for the failure to adhere to adequate disclosure standards. The intention of SC is to shift the regulatory approach from a merit-based to a disclosure-based system of regulation so that investment decisions made by each individual investor are based on complete and reliable information provided by the issuer or offeror of securities.

Previously, under the merit-based system, the SC would assess the pricing of securities, utilisation of proceeds arising from the issuance of securities, valuation of assets and the overall viability of the corporate proposal to ensure that only "quality securities" were made available to investors. The SC's Asset Valuation Audit

Department was established in 1995 to provide fair consideration of corporate proposal submitted by public companies that were involved in property asset valuation. Prior to this, the valuation was undertaken by the Ministry of Finance, a practice carried over from the Capital Issue Committee.

The merit-based system was adopted at the early stage of capital market development with the purpose of safe guarding the investors, especially the retail investors from potential fraud or market misconduct. However, this has caused a moral hazard as investors would perceive that the company would be a good investment, and it is needless to evaluate the merits or risks of investing. Seaward (1993) provided evidence that the average underpricing of IPO in Malaysia was extremely high at 149 percent as a result of the merit-based system. In 2003, in an effort by the SC to be a full-disclosure-based regime, the 1996 Guidelines on Asset Valuation were amended to incorporate requirements for higher disclosure standards and due diligence by the valuers. It has categorised assets as identified/non identified. Only those assets that fell under the "identified" category, such as property assets where valuation abuses were most likely to occur, will be reviewed by the SC (SC, 2004).

The implementation of the disclosure-based system also saw that directors, substantial shareholders and persons connected with the companies were prohibited from voting on any resolution on a related party-transaction (SC, 2004). In order to further enhance transparency, an amendment was made in 1998 to the Securities Industry (Central Depository) Act 1991. The amended Act required that the identity of the owners who held shares in nominee account exceeding 5 percent must be revealed.

The Guidelines for the Reverse Take-overs and Backdoor listing was introduced in 1994, induced by the increasingly popular method of going public by reverse take-overs in the early 1990s. The period 1993-1994, in particular, was characterized as highly speculative. A reverse take-over announcement would lead to spectacular escalating prices without due regard for the regulatory risks involved or its real future potential. This was especially, in the tin, property and plantation sectors where their indices outperformed the rest, which climbed on expectation on reverse take-over bids. During that year, the Plantation Index rose by 219 percent, Tin Index by 379 percent, and Finance Index rose by 224 percent. The reverse take-overs comprised acquisitions of timber concessions, stock broking companies as well as oil and gas businesses.

The reverse take-over as a popular mode to get a company listed could be due to the inefficiency of the approval process. It was difficult to get companies listed due to the long waiting time and bureaucracy in the early years. As a case in point, a take-over bid for a listed company required approval from the FIC (which was in the Prime Minister’s Department) and subsequently the CIC (under the Ministry of Finance). If the proposal is approved, then it would be submitted to the panel on Take-over and Mergers (under the Ministry of Trade and Industry) for further evaluation and approval. On top of this, it also required approvals of the relevant sectoral regulators of companies involved in the take-over bid. For instance, if a financial institution was involved, Bank Negara Malaysia’s approval was required; and if a manufacturing company was involved, the approval of the Ministry of Trade and Industry was needed. In addition to the many agencies involved, most of the committees in charge did not operate on a full time basis and each had its own guidelines and conditions for approval.

The supervision and development of the capital market at that time were merely a secondary function of the various regulatory authorities. This had resulted in opportunistic taking activities whereby some deals even involved selling their listed