CHAPTER 1

INTRODUCTION

Andrew Dodd (1994) defines that a takeover occurs when a company acquires another company through:

o purchase of business operation and company's assets.

o purchase of company shares that results in transferring of controlling interest.

An acquisition can be made by cash, by shares or a combination of part cash and part shares. An acquisition can either be partial or in full. In a partial acquisition, a company normally purchases less than 100% of the company's equity shares but usually more than 50% to obtain control. In a full acquisition, the entire share capital of the acquired company is purchased. Due to the globalisation process, there have been some cross border takeovers, such as the CASH case in Malaysia in 1994. The cross border acquisition will continue as it is sometimes the fastest way to gain access into market and incorporate the business locally.

Takeovers in Malaysia are regulated by the Security Commission after March 1993. Before the existence of Security Commission, takeovers were regulated by The Panel on Takeovers and Mergers (TOP), operating under the Code on Takeovers and Mergers 1987. Under this code, a mandatory offer is inevitable by any person or party acting in concert that acquired in excess of 33% of the voting rights of a firm, or any person or party acting in concert that has accumulated between 33% to 50% of the voting rights, and has purchased an additional 2% of the voting rights within the one year period. These definitions on takeovers and mergers will be used in this research, to identify acquired companies in KLSE during the bull run of August 1990 to December of 1993 (as indicated by the shaded area in appendix B).

In any acquisition, there must be seller(s) and buyer(s) . A seller is willing to part with his company or controlling stake when:

- o the offer price is attractive,
- o the business is not profitable,
- o he wishes to refocus on core business and selling the non-core business.
- o he lacks funds.

On the other hand, a buyer will be willing to commit his/her resources to purchase the company or controlling stake when:

- o it provides an opportunity to gain access into the market and business,
- o the acquirer intends to buy out competitors,
- o there is a desire to diversify or to integrate vertically,
- o it provides an opportunity to achieve business, management or financial synergy,
- o the government's privatization program requires a listing vehicle,
- o the target is grossly undervalued or its value is expected to grow,
- o there are plenty of valuable assets in the target company.

Accordingly, a rational business consideration in a takeover exercise based on the theory of a firm is that to the acquirer, the target must be undervalued, provided required synergistic effects, and with as little liability as possible.

There have been evidence in the United Kingdom, United States and other part of the world that takeover activities increase during the bull run period and decrease during period with bearish sentiment. The Kuala Lumpur Stock Exchange (KLSE) in

1992 and 1993 was experiencing a very phenomenal bull market in comparison to other periods in the KLSE history. Trading volume was heavy and stock prices appreciated rapidly across the board. In spite of the sharp price appreciation, there were flurries of acquisitions and reverse takeovers over the same period of time. During this time period, investors and traders in KLSE would react favourably to takeover news. These takeover activities fueled the rumours mill of the KLSE and had sent some of the share prices of the targeted companies to very high levels. Some takeover rumours, like the Union Paper Holdings Berhad case on the Second Board actually resulted in heavy losses to investors who chased up its stock price based solely on these rumours.

Objectives

The purpose of this research is to investigate the financial characteristics of the acquired companies that made them attractive to the acquiring firms in KLSE during bull run. The specific objectives of this research are:

(1) to determine the underlying important characteristics shared among the acquirees,

(2) to determine the differences between acquirees and non-acquired firms in the bull market of August 1990 until December 1993, and

(3) to summarize the important characteristics among the acquired firms.

Significance

The results of this research will provide a platform to test whether the notion of managerial economics that a firm will acquire another if it is undervalued holds or not during a bull run. As mentioned earlier, past researchers had noted that acquisition activities were heaviest during bull run and were scarce during bear period. It is also a known fact that share prices generally are high during the bull period.

The results of this study will also be of significant value to the investing public, as it will allow them to determine the likelihood of a company being acquired in a bull run. It provides a platform for them to zero in on the actual characteristics that make the acquired company attractive to the bidder. Hopefully, this will be of some assistance to the investing public to verify takeover rumours.

Finally, the outcome of this research could be used by the public listed companies to undertake proactive programs to avoid being targeted as a company to be acquired. Likewise, the results from this study could be utilized by the seller to package the company so that it becomes an attractive target to potential acquirers.

Scope and Limitations of the Study

The scope of this study is the acquired companies listed in the KLSE that were involved in takeovers during the bull period of August 1990 to December 1993. Companies acquired that were suspended from the KLSE were excluded from this study as it was difficult to search out representative companies to be their control group.

One limitation of this research is that the result is confined only to the KLSE. Similar researches from other countries may yield different results, due to differences in socio-economic and political situations. Another limitation of this study is that it is conducted during the bull period from the month of August 1990 to December 1993. Efforts to find out the characteristics of firms acquired during the bear period of 1984 to 1986 was unsuccessful. The period in 1984 to 1986 corresponded to the recessionary period in Malaysia with very little takeover activities in Kuala Lumpur

Stock Exchange. There were a total of 11 takeovers in this period, six of which were rescue plans for reviving suspended companies such as United Engineers (M) Bhd., Imatex and others. The number of acquired firms listed and traded in Kuala Lumpur Stock Exchange during this period numbered only five companies. This sample size is too small even for t-test. It was further decided that these five companies that were acquired during the bearish period be dropped from this research, and to confine this research to a period clearly identifiable as bull period in the KLSE. Hence, the result of this research will be representative only during bull period, and particularly for the time period from August 1990 to December of 1993. Finally, using accounting data for ratio analysis causes additional limitations. The basic limitation of accounting data is that there could be differences between companies when different accounting policies are being used to prepare company's accounts. The assets of the firms are also based on the purchased value and may be very different from their current market values. These accounting limitations fortunately were less significant in this study, as the research was conducted using comparative pairing technique that involved companies from similar industry with relatively similar sizes.

Organization of the Report

This research paper is organized into five chapters. A brief content of each chapter, with its title in bracket is listed below.

Chapter 1 (Introduction) starts with describing the general mechanics of takeovers and the regulations pertaining to takeovers and mergers in Malaysia. It also lists down the objectives, scope and limitations of this research, its significance to the corporate's managers and the investing public.

Chapter 2 (Literature Review) summarizes the empirical results and the general characteristics of the acquired companies found by the authors of those literatures reviewed. The literatures reviewed cover both foreign and local research findings.

Chapter 3 (Research Methodology) is organized into four sections. The first section lists the hypothesis to be tested. The second section describes the data collection method used in this research. The third section includes the formulae and descriptions of all the financial ratios employed in this study. Finally, the last section explains the types of statistical tools and their analysis criteria used in this research.

Chapter 4 (Research Results) is separated into four sections. The first section provides a general overview on the results obtained in this study. This is followed by univariate analysis, which tests the hypothesis stated earlier in Chapter 3. The third section of this study summerizes the characteristics of both the aquiring and acquired firms using factor analysis. The last section of this chapter provides explaination to the results of the data analysis using multiple discriminant analysis.

Chapter 5 (Conclusion and Recommendations) summarizes the findings of this study. This chapter also provides some suggestions for future researchers. Finally, the implications from the results of this research to the corporate world are also discussed in this chapter.