CHAPTER 1

INTRODUCTION

Overview

Individual and corporate investors are constantly looking out for opportunities to expand their business. They can either expand their organisations by way of organic growth or via acquisition of other firms. While organic growth of an organisation will take a longer time, companies which want to expand rapidly may opt for acquisition of other companies. Since recovering from the economic recession of 1985-1986, we have seen a steadly rise in the takeover activities in Malaysia's corporate scene. The number of takeovers of companies listed in Kuala Lumpur Stock Exchange increases from 8 in 1989 to the peak of 33 in 1993. It has been observed in the history of local as well as overseas markets that takeover activities mainly take place during economic boom and this observation is further confirmed by the evidence of the recent bull run in 1993.

Different firms may have different objectives in their acquisition pursuits and hence different criteria are used to evaluate the takeover targets. A firm may acquire another for strategic reason, it may look for under-valued companies, it may seek out those companies which can be more profitably run under better management, etc. Many studies done on the financial characteristics of acquired companies and the motives of acquisition have led to various theories of firm. Whatever is the reason of acquisition, a premium price will normally have to be paid for such takeover. Despite the premium price, the acquisition must still be of value to the acquiring firm to make any economic sense. In other words, the acquisition should increase the wealth of the shareholders of the acquiring firms.

Some Definitions On Mergers and Acquisitions

Different researchers may have slightly differing definitions for mergers and acquisitions. In his book on takeovers, Ajit Singh (1971) defined an acquisition as when a company acquired more than 50% of the voting shares of another company. However, in the Malaysian Code on Takeovers and Mergers (1987) issued by the Securities Commission of Malaysia, an acquisition is deemed to have occured when a company acquires more than 33 1/3 % of the voting shares of another company. For the purpose of this study, we define the various terms as follows :

Merger

A merger is defined as when two companies, usually of about the same size, amalgamate or merge under one company which may or may not be one of the original two companies. The shareholders of this new company are essentially the existing shareholders of the original two companies.

Acquisition

When company A acquires more than 33 1/3 % of the voting shares of company B, an acquisition is deemed to have occured and the control of company B is passed over to company A. Such an acquisition by company A can be carried out by :-

i) paying cash for the shares of company B,

ii) issuance of company A's shares in exchange of the shares of company B,

iii) injection of some assets of comapny A into company B in exchange for the shares of company B.

The term takeover is sometimes used to denote acquisition and both terms are used interchangeably.

Reverse Takeover

A reverse takeover occurs when the acquisition of company B via issuance of company A's shares resulted that the original shareholders of company B becoming the majority shareholders of company A after the acquisition. In this case, the control of company A passes over to the shareholders of company B as a result of the acquisition.

Acquirer and Acquiree

The acquirer is defined as the company that assumed control of another company. An acquiree is defined as a company whose control has been passed over to the acquirer as a result of the acquisition. In the case of takeover, the acquiring firm is the acquirer. However, in the case of reverse takeover, the acquiring firm become the acquiree as its control have been passed over to the shareholders of the firm it acquired.

Objectives and Significance of Study

The purpose of this project is to study the financial performance of the acquirees after their acquisitions by others to see if there is any real improvement in the acquirees' performance under the new owners. Unless the acquirees improve in performance and increase their shareholders' wealth, there may be little justification for the high premium price paid for such acquisitions. This study tries to gain some insights into how Malaysian companies fare after acquisition. It is hope that this information may be helpful to the investing public in their evaluation of their investment in the acquirers and/or the acquirees.

Scope and Limitation of the Study

This study covered only a sample of the takeovers and mergers cases that took place during 1989 to 1992 period. Since Malaysian economy was growing at the average of eight (8) percent per annum during this period, the firms chosen may be considered to be representative of the normal firms acquired during the economy boom. As such, the findings thereof would give an indication of the financial results of the merger and acquisition activities during booming economy.

It shoud be noted that in view of the limited scope of this study, i.e. the small sample of the acquirees and the short period during which the mergers and acquisitions took place, the findings may not be interpreted in general terms.

Organisation of This Report

The research paper is organised as follows :

Chapter 1 describes the background, objectives and significance of the study on the post- acquisition performances of the acquired companies. It also discuss the measures of financial performances used and the limitation of this study.

Chapter 2 looks at the past mergers and acquisitions activities of developed countries, mainly United States and United Kingdom as they are the leading financial centres of the world. It also looks at the rationales and motivations of the mergers and acquisitions. The financial expectation of such corporate manouvers is also briefly discussed.

Chapter 3 describes the sources of the research data and the criteria for the selection of sample and control data. The general categories of the various financial ratios are discussed. The formulae used to calculate the financial ratios are also identified and clearly defined. The statistical technique used to analyse the data are also outlined and discussed.

Chapter 4 discusses the results of the study. The chapter looks at the general financial characteristics of both acquired and control companies in the year preceeding the acquisitions. The major differences in characteristics of the two groups are discussed. The trends in performances of the various financial ratios are highlighted.

Chapter 5 summarises the findings of the study. In view of the limited scope of this study, areas for further research on this subject are discussed and recommended.