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Does financing of Chinese mergers and acquisitions have "Chinese characteristics"?

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HIGHLIGHTS

- We investigate the financing of Chinese mergers and acquisitions (M&As).
- Our sample includes over 6000 domestic and overseas M&A deals from 1997–2014.
- We find no difference between SOEs and non-SOEs in their use of cash financing.
- We find that overseas M&As are significantly less likely to be financed with cash.
- The latter result is consistent with foreign ownership restrictions.

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ABSTRACT

This paper analyzes the financing of Chinese mergers and acquisitions. It is motivated by two issues associated with characteristic features of the Chinese economy. First, foreign ownership restrictions can potentially inhibit Chinese acquiring firms' use of equity to finance overseas M&A deals. Second, the ability of state-owned enterprises (SOEs) to secure favorable loan terms may provide them an incentive to rely more on cash financing. We collate data from four databases to obtain a sample of over 6000 M&A deals that were completed during the 1997–2014 period. We find evidence to support the first supposition but not the second.

1. Introduction

This study analyzes the financing of Chinese mergers and acquisition (M&As). China's burgeoning financial sector has attracted much attention from researchers. It is notable for a number of characteristics. The Chinese government heavily regulates foreign ownership of Chinese companies.[1] Further, the influence of state-owned enterprises (SOEs) makes the market for corporate control different from developed countries.

How M&As are financed is important because it can substantially impact a firm's ownership structure, debt burden, and subsequent liquidity. While numerous studies of M&A financing in developed countries exist (e.g., Faccio and Masulis, 2005), very few exist for emerging markets, and only one exists for China (Boateng and Bi, 2014). This study examines the financing behavior of over 6000 Chinese M&A deals completed between 1997 and 2014, with particular focus on the impact of foreign ownership restrictions and the role of SOEs.

2. Data

The initial sample for this study was drawn from the *Zephyr* database, which contains information on approximately 1.3

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1 See Sun (2013) and Yao (2015).

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Table 1
Financing of deals.

CASH1			*CASH2*		
Values	*Domestic*	*Foreign*	*Values*	*Domestic*	*Foreign*
3	5916 (*83.9%*)	212 (*90.6%*)	***1***	6168 (*87.5%*)	214 (*91.5%*)
2	539 (*7.7%*)	4 (*1.7%*)	***0***	879 (*12.5%*)	20 (*8.5%*)
1	592 (*8.4%*)	18 (*7.7%*)	*Total*	7047 (*100%*)	234 (*100%*)
Total	7047 (*100%*)	234 (*100%*)			

Note: The variable *CASH1* takes the value 3 if financing is entirely by cash, 2 if it is a mixture of cash and other means, and 1 if no cash is involved. The variable *CASH2* takes the value 1 if more than 50% of the value of the deal is financed by cash; otherwise it takes a value of 0.

Table 2
Variable definitions and predictions.

Variable	Definition	Prediction
Variables of interest		
FOREIGN[a]	Takes value 1 if M&A target firm is foreign; 0 otherwise	+
SOE[a]	Takes value 1 if parent firm is government; 0 otherwise	+
Acquirer-related characteristics		
MARGINAL CONTROL[b]	Takes the value 1 if the largest equity holder holds more than 35 but less than 50% of the acquirer's shares	+
LISTED OVERSEAS[c]	Takes value 1 if acquirer is listed overseas; 0 otherwise	−
CASH HOLDINGS[d]	Percent of total assets held as cash	+
PAYOUT[d]	Payout ratio	+
TOTAL ASSETS[d]	Log of acquirer's total assets	+
COLLATERAL ASSETS[d]	Share of acquirer's total assets held in the form of property, plant, and equipment	+
PROFITABILITY[d]	Earnings before interest and taxes as a share of previous two years' total assets	+
MB RATIO[d]	Acquirer's market to book ratio	−
DEAL SIZE[a,d]	Ratio of deal value over (deal value + acquirer's market capitalization)	−
EXPENSES[d]	Selling, general, and administrative expenses as a share of net revenues	−
DEBT[d]	Debt as a share of total assets	−
INTEREST[d]	Interest payments as a share of total assets	−
TAXES[d]	Taxes as a share of total assets	−
Target-related characteristics		
RELATED INDUSTRY[a]	Takes the value 1 if acquirer and target firms are in the same three-digit SIC category; 0 otherwise	−
HIGH TECH INDUSTRY[a]	Takes the value 1 if target firm is a "high technology" firm; 0 otherwise	?
RESOURCE INDUSTRY[a]	Takes the value 1 if target firm is a "resource" firm; 0 otherwise	?
TARGET UNLISTED[a]	Takes the value 1 if the target firm is unlisted; 0 otherwise	+

[a] Data source is *Zephyr*.
[b] Data source is *Wind*.
[c] Data source is *CSMAR*.
[d] Data source is *Datastream*.

million M&A deals; as well as *Datastream*, *Wind*,[2] and *CSMAR*.[3] We deleted deals (i) completed outside the 1997–2014 window, or that involved (ii) finance target firms or (iii) acquiring firms that did not have an ISIN number or had a non-positive market-to-book ratio.

M&A deals are typically financed via cash, equity, and/or debt. Table 1 reports financing details for 7047 domestic M&A deals, and 234 overseas M&A deals.[4] The variable *CASH1* takes the value 3 if financing is entirely by cash, 2 if it is a mixture of cash and other means, and 1 if no cash is involved.

Given the relatively small percent of mixed deals, the subsequent analysis creates two categories of deals: those primarily financed by cash (*CASH2* = 1), and others (*CASH2* = 0). This facilitates the interpretation of marginal effects in the subsequent probit analysis. However, our results are confirmed with (i) a two-sided Tobit procedure that uses the percent of cash-financing; and (ii) an ordered probit procedure that accounts for the three levels of financing in *CASH1*.[5]

Guided by the extensive literature on M&A financing, we assembled a large number of control variables. Table 2 defines the variables used in this study, along with their predicted effects. A positive prediction indicates that a variable is expected to increase the probability a deal is financed with cash.

The main variables of interest are *FOREIGN* and *SOE*. We expect foreign ownership restrictions to cause Chinese companies to rely more on cash when financing overseas M&As. We also expect SOEs to disproportionately employ cash because they are known to face lower borrowing rates (Buckley et al., 2007). Investigating these two issues is the main motivation for this study.

Given the large number of acquirer-related and target-related control variables, we only discuss those that will be significant in the later analysis. *MARGINAL CONTROL* takes the value 1 if the

2 *Wind* is a Chinese financial database. It is described here: http://www.wind.com.cn/En/Default.aspx.

3 *CSMAR* is a Chinese financial database described here (in Chinese): http://www.gtarsc.com/Home.

4 All the data used in this study, along with the Stata do files used to generate the results, are available upon request from the authors.

5 The Tobit and Ordered Probit results are reported in an accompanying appendix.