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Can material asset reorganizations affect acquirers' debt financing costs? – Evidence from the Chinese Merger and Acquisition Market☆

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ABSTRACT

In this paper, we investigate whether material asset reorganizations (MARs), a special form of merger and acquisition (M&A) transactions, can affect the acquirers' cost of debt financing. Further, we examine the effect of acquiring firms' accounting information quality on the cost of debt and on the association between MARs and debt costs. We predict that compared to conventional M&As, large-scale acquisitions through MARs can generate a much greater influx of assets from target firms. This raises the acquirers' asset collateral and thus reduces the cost of debt. Because the quality of accounting information is a key factor affecting the cost of debt, we suggest that it has a spillover effect on the debt-cost effect of MARs. Using M&A transactions by listed companies in the Chinese A-share market from 2008 to 2014 as our sample, we find that MARs are associated with a higher asset collateral and lower ex post cost of debt than conventional M&As. Furthermore, we show that the acquiring firms' accounting information quality has a significant negative effect on debt costs, and the negative association between MARs and the cost of debt is more pronounced when accounting information quality is higher.

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1. Introduction

Merger and acquisition (M&A) transactions are a widely discussed issue in research on capital markets. Earlier academic research mainly focuses on the motivation for conducting M&As, including obtaining business synergies, consolidating market position, and building a "commercial empire" (Jensen and Ruback, 1983; Mullin, 1995; Martynova and Renneboog, 2006). The recent literature focuses on whether M&A transactions create wealth value in stock markets, and explore the determinants of this value-creation (Zhang, 2003; Martynova and Renneboog, 2011; Cai and Sevilir, 2012; Tian et al., 2013; Chen et al., 2013a; Kravet, 2014; Mateev, 2017). However, there is little research on the economic consequences of M&As in debt markets. In this paper, we investigate whether and how material asset reorganizations (MARs),[1] a special form of M&A transactions, can affect acquirers' ex post debt financing costs.

The theoretical and empirical literature (e.g., Wang et al., 2014) shows that the cost of debt financing is directly related to borrowing firms' credit risk. Research also finds that creditors rely on the collateral and the quality of accounting information to reduce credit risk and manage loan protection (Chen et al., 2013b; Wang et al., 2014; Pan and Tian, 2016). The MAR is a special form of M&A and has a much higher magnitude than conventional M&A transactions. Thus, MAR implementation could mean that a large amount of assets flow to the acquirer from the target firm, enabling the acquirer to possess considerably greater asset collateral. This would reduce debt financing frictions, lowering the ex post cost of debt. In capital markets, accounting information serves as a crucial "bridge" between a corporation and its investors, because it reflects the firm's financial status, operating results and changes in cash flow. When the accounting information is of high quality, it indicates that the firm's true financial information is reflected to a large extent, so external investors can rely on financial statement numbers and use them to reduce information risk and make rational investment decisions. As a result, the firm's accounting information quality is negatively associated with its debt financing cost (Francis et al., 2005; Spiceland et al., 2016). In addition, when the acquiring firm's accounting information quality is higher, MAR implementation can more effectively reduce debt financing costs, because detailed acquisition information must be disclosed to meet China Securities Regulatory Commission (CSRC) requirements, and newly added asset collateral in the MAR transaction is incremental in perfect information environments.

In this paper, we focus on China's capital market because it provides an excellent setting for our research questions. First, the use of collateral to mitigate agency conflicts is more critical and widespread in emerging markets because the information environment is relatively opaque, and liquidation payoffs and competition between capital suppliers are lower than in developed markets (Chen et al., 2013b; Pan and Tian, 2016). Lu et al. (2008) and Chen et al. (2013b) argue that borrowing firms' accounting information quality can be another effective tool to alleviate debt agency problems in emerging markets, where laws, institutions, and enforcement efforts are generally weak. Collectively, the asset collateral and accounting information quality of borrowing firms are key factors that affect their debt financing cost in emerging markets (Wang et al., 2014). China has the largest emerging capital market. Unlike developed capital markets such as the United States and Europe, it still suffers from poor legal enforcement and weaker information circumstance, although it has grown tremendously, and the investor protection system is gradually being standardized (Li et al., 2013). Therefore, studying the debt-cost effect of asset collateral and accounting information quality in China's capital market is highly relevant and meaningful. Second, under pressure to transform and upgrade China's macro industrial structure, the Chinese government has enacted many policies to promote M&A activities in enterprises. Therefore, M&A transactions are increasing rapidly in the capital market, both in terms of the number of transactions and the size of each transaction (Han and Tang, 2017). These large-scale M&A

[1] According to the management regulation of material asset reorganizations (MARs) of listed companies issued by the China Securities Regulatory Commission (CSRC), a M&A transaction is identified as a MAR if it meets one of the following standards. (1) The total assets purchased by the acquirer account for over 50% of its year-end total assets of the audited consolidated financial statement in the latest fiscal year. (2) The sale income from the assets purchased by the acquirer in the latest fiscal year accounts for over 50% of its sale income of the audited consolidated financial statement in the same period. (3) The net assets purchased by the acquirer account for over 50% of its year-end net assets of the audited consolidated financial statement in the latest fiscal year, and the value of purchased net assets is more than 50 million RMB.

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