Performance Evaluation on the Acquisition Cases in Hong Kong

LEUNG Tak Yan

A thesis submitted in partial fulfillment of the requirements for the degree of

Master of Philosophy

May 1998

Hong Kong Baptist University
Abstract

The study aims to examine whether the merger and acquisition investments put forward by the Hong Kong acquiring firms would be able to fulfill their proposed objective to enhance the value and profitability of the post-acquisition acquired, acquiring and combined firms. Two methodology approaches are used to evaluate both the short-term and long-term performance of the 36 pairs of acquired and acquiring firms over the sample period between 1986 and 1994. The event study results indicate that there were immediate share price gains to the combining firms around the acquisition announcement period. However, the financial ratio analysis on the various performance indicators and the ranking value evaluation on the several performance indices cannot show that the acquired and acquiring firms have experienced significant long-term performance improvement over the two years after the acquisition year. No correlation was found between the short-term returns and the long-term performance indicators. Not all the merger and acquisition theories developed are applicable for explaining the Hong Kong takeover market and the study attempts to sort out other possible motives for the Hong Kong acquiring firms to engage in the acquisitions.
# Table of Contents

Abstract ................................. i
Acknowledgment ......................... ii
Table of Contents ........................ iii
List of Tables ............................ v
List of Figures ........................... vii

Chapter 1  Introduction .................. 1

Chapter 2  Literature Review .......... 5
2.1 Review on Theoretical Background and Evidence 5
2.1.1 Synergy .......................... 6
2.1.1.1 Operating Synergy ............. 6
2.1.1.2 Financial Synergy ............. 7
2.1.2 Efficiency Hypothesis .......... 10
2.1.2.1 Differential Efficiency Hypothesis 10
2.1.2.2 Inefficient Management Hypothesis 11
2.1.3 Diversification .................. 13
2.1.4 Merger and Agency Cost Problem 19
2.1.4.1 Manner Explanation on Merger 21
2.1.4.2 Managerialism (Managerial Risk Reduction Hypothesis) 23
2.1.4.3 Free Cash Flow Hypothesis .... 25
2.1.5 Profit Maximization .............. 27
2.1.6 Size-, Growth-and Managerial Utility - Maximization 33
2.1.6.1 Size Maximization .......... 33
2.1.6.2 Growth Maximization ......... 34
2.1.6.3 Managerial Utility Maximization 35
2.1.7 Financial Market Inefficiency and Information Asymmetry 45
2.1.7.1 Undervaluation Hypothesis ... 46
2.1.7.2 Economic Disturbance Theory 49
2.1.7.3 Information Theory .......... 51
2.1.8 Hubris Hypothesis ............... 53
2.1.9 Overview ........................ 54
2.2 Review on Methodology .......... 58
2.2.1 Event Study Analysis .......... 58
2.2.2 Long-term Performance Evaluation Approach by Healy, Palepu and Ruback (1992) 65