

Political Connections and Merger Performance: Evidence from Chinese Market

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Abstract

In this paper, we examine the role of political connections by analyzing the short- and long-term performance of Chinese state owned enterprise (SOE) acquirers relative to private owned enterprise (POE) from 1994 to 2008. The empirical result shows that 1) SOE acquirers outperform the POE acquirer both in terms of long-run stock and operating performance; 2) announcement effect of POE acquirer taking over SOE target is significantly positive; 3) SOE-related mergers have superior stock performance during hot political periods. Moreover, our evidence shows that SOE acquirers have higher operating margin but lower asset turnover, suggesting the outperformance of SOE acquirers are due to their superior profitable business instead of efficient usage of asset. Compared to POE acquirers, SOE acquirers also have lower leverage ratio, higher quick ratio as well as more asset value. These finding suggest that the value of SOEs acquisitions is derived from government financial and policy support because of their political connections.

JEL Classification: G14; G34.

Keywords: Merger and Acquisitions, Market Valuations, Political Connection, Chinese Market

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1. Introduction

A growing literature shows that political connections exert considerable influence on firm value¹. Although a number of studies show that firms with political link are better off, the value of political connections is not necessarily positive in theory. Shleifer and Vishny (1994) argue that politicians who grant subsidies to connected firms may also request a rent, such as bribes or political benefits. Perhaps, the most predominant demerit of political ties occurs in the government-owned companies. Boycko et al. (1996) argues that government-owned companies chase social and political aims, such as excess employment, instead of creating their own value. Dewenter and Malatesta (2001) among others provide supportive evidence that government-owned companies across the world operate less efficiently and have lower profitability than their private counterparts. Observations from privatization also suggest that cutting off the political connections, through either selling or diluting government's stake in the firm's ownership, would enhance the value of enterprises previous controlled by government (Megginson and Netter 2001).

Despite the prevailing view that the political influence is highly likely to destroy the value of government-owned companies, the evidence in Chinese market is controversial. Sun and Tong (2003) report a negative relation between state ownership and firm performance, including earnings ability, sales, and employment productivity. Chen et al. (2008) investigate the control transfer of Chinese listed companies. They find a positive market response and improved performance following ownership transfer from government to private. However, other empirical evidence shows that state-owned enterprises (SOEs) in China seem to enjoy the benefits from government support, which offsets the cost of inefficiency. Calomiris et al. (2010) report a significant proportion of Chinese listed SOEs' value comes from government ownership in cross-sectional analysis. They find negative market reaction to announcement of reducing the state ownership plan, and positive announcement effect on cancelation of that plan. Moreover, several researchers suggest a nonlinear relation between government ownership and corporate values in Chinese market (Ng et al. 2009, Tian and Estrin 2008). In short, from previous mixed results, the question remains that whether political connections contribute to the valuation of SOE firms, and where the value, if any, comes from.

In this study, we investigate the role of political connections in acquirers' valuation and performance in Chinese market. Merger as one of important corporate decisions is

¹ Fisman (2001) shows that stock returns of politically dependent firms in Indonesia are affected by rumors about

naturally a good testing ground of this issue. Government policies and regulations are documented to have direct impact on merger activities, such as anti-trust policy, deregulation of financial sector, etc². It is intuitive that such political impact on merger outcomes would be more substantial to political connected firms. We use state ownership of listed companies as a proxy for political connections. The firms whose dominant owner is the government, i.e. SOEs, are considered to have more political connections than other private owned companies (POEs). According to Company Act of 1993, the board members of SOEs are assigned by SOE Asset Supervision and Administration Commission (SASAC). These board members also serve as government officers with high-rankings. Francis et al. (2009) report that 44.7% of new listed SOEs have a political connected board members, which is significant larger than that of non-SOEs firms. The link between political ties and SOEs is robust in China.

The first research question addressed in this study is whether SOEs engage in more or less profitable merger deals than their acquiring counterparts. Using the comprehensive sample of 825 merger deals from 1994 to 2008, we find that acquirers taking over SOE targets have higher announcement abnormal returns (1.36%) than those taking over POE targets (0.67%). POE acquirers taking over SOE targets gain highest CARs (2.49%) than SOE acquirers (0.25%), indicating that SOE target is more valuable to POE firms. In the long-run, SOE acquirers have 24.59% 2-year BHARs, much larger than POE acquirers (16.91%). Moreover, the highest long-run performance appears to be associated with SOE acquirers taking over another SOE target.

We further hypothesize that if superior post-performance of SOE acquirers is because of their political connections, their gains should be greater and more significant when political intervention is more intense. National People's Congress (NPC) and People's Political Consultative Conference (CPPCC) held together every year are the most influential political events in China³. Local People's Congress (LPC) gathers in each province shortly before or after NPC and CPPCC. One major objective of these congresses at all level is to pass new economic development policies and industrial schemes (Hasan et al. 2009). We construct the window of political opportunity as one month around the NPC and CPPCC⁴. We assume an

² See Martynova and Renneboog (2008) for detail survey of merge characteristics and outcomes in the history.

³ "Friday will mark the start of China's political event of the year, the National People's Congress, whose nearly 3,000 members will meet in Beijing to ratify laws and plans set by party leaders." --- Wall Street Journal, on March 4th, 2010.

⁴ To avoid any selection biases of length of event window, we also use alternative 15 days around the NPC and CPPCC, which is consistent with the main results.

increased likelihood that mergers announced during this window are more influenced by politics than those out of this window. We also include the exact month that new regulation of M&As is announced, which has direct impact on M&As market (see section 2.2 for further details).

Consistent with our hypothesis, the results show a significant role of political influence in M&A outcomes. SOE acquirers outperform POE acquirers both in the short-run and long-run during hot political periods, indicating that government intervention increases the value of political connections. Acquisitions of SOE targets receive more positive market reactions during hot political periods. SOEs taking over SOEs during hot political periods have the best long-run performance (68.05% BHARs) among all other merger deals. It is evident that political influence has a significant positive (negative) impact on connected (unconnected) mergers. These results are robust in multivariate regression test with controlling for other factors.

To better understand why political connections have such influence on M&As performance, we further investigate several potential explanations. First, after over 30 years' economy reform and privatization, the Chinese government today keeps a strong control over every aspect of business and economics (Calomiris, Fisman and Wang 2010). It insists on the fundamental status of SOEs in the whole economy, and supports them with material beneficial policies.

"...The fifteenth National People's Congress presents that: 'state-owned economy has to take the leading role, mainly reflected in the ability to control. ... to maintain absolute control on national security and national economy important industries including military industry, power grid, petroleum and petrochemicals, telecommunications, coal, civil aviation, shipping, etc. '...'"--- People's Daily, on April, 1st, 2010.

These policies, such as industry license, market-entry barriers, financial bailouts, may discriminate in favor of SOEs with less restriction and higher marginal profits. Second, Chinese financial market relies heavily on bank financing, which is mainly provided by four largest state-owned banks (Allen et al. 2000). Cull and Xu (2003) find that SOEs have preferential access to bank loans as well as government transfers. Such priority has been proved to be vital to firm's growth and performance in China (Ayyagari et al. 2010). In addition, when issuing new equity, SOEs are found to benefit from higher offering prices and lower floating costs, compared to newly listed firms without political ties (Francis, Hasan and

Sun 2009). Financial support may attribute to the better performance of SOE acquirers. Last but not least, Vickers and Yarrow (1991) argue that agency cost of private firms may diminish the relative inefficiency of government ownership. In line with this point, Chen et al. (2009) examine the operating performance of Chinese listed companies and find that efficiency of private controlled company is not superior to that of SOEs. Their results indicate a positive role of government monitoring on SOEs' managers that lowers the expropriate risk and therefore enhances firm's value. This interpretation suggests a positive impact of political connections on firms' governance, which leads to relative outperformance of SOE acquires.

To shed light on the reason why SOE acquirers outperforms in the long-run, we further investigate the operating performance and other characteristics of acquirers. All accounting measures are adjusted by industry median value, to make acquisitions comparable across industries. The post-merger operation shows that SOE acquirers have higher profitability than POE acquirers. Acquiring a SOE target seems to increase the profitability of SOE acquirer, but destroy POE acquirer's value. This finding is consistent with post-merger stock performance, suggesting that outperformance of SOE acquirers is based on firm operating instead of market mispricing. Moreover, SOE acquirers have higher operating margin, offsetting their relative low asset turnover. It seems that SOE acquirers have more profitable business but lower efficiency of asset usage. The evidence also indicates that SOE have larger asset, more cash reserve, and low asset value per capita, suggesting that SOE acquirers have more finance resource than their counterparts.

Our study contributes to the literature in several ways. First, although a plenty of researchers have investigated the relation between political connections and firm value, none of them, to our knowledge, pays close attention to the M&As market. Our research tries to fill this literature gap. The superior post-merger performance of SOE acquirers, especially during political event and announcement date of new regulations, suggests that political connects do affect the outcomes of M&As. We provide additional evidence from Chinese M&As market that the impact of political connections is substantial on firm value (Claessens et al. 2008, Faccio 2006, Fisman 2001, Goldman et al. 2009).

Second, Chinese has been one of the largest economies⁵, while we still know little about how its unique institutional setting interfere industries and business. Our evidence

⁵ "China surpassed Japan as the world's second-largest economy last quarter, capping the nation's three-decade rise from Communist isolation to emerging superpower." ---Bloomberg, Aug 16, 2010.

suggests that commerce and business are affected by the major political events in China, including NPC and CPPCC, and announcement of new related regulations. In fact, even rumors about government intervention have material impacts on Chinese markets⁶. We provide the evidence that M&A outcomes, especially SOE-related deals, are significantly affected by these political events. This finding suggests that value of political connections is positively associated with political intervention. More intense government interference, more valuable is the political connections.

Moreover, the literature in Chinese M&As market is relatively sparse. Previous studies including Agyenim et al. (2008) and Tuan et al. (2007) are based on very small sample compared to ours. Given the rapidly increasing magnitude of Chinese M&As market (\$8.68 billion in 2008), it is worth a comprehensive study in its own right. Our results show acquirers experience positive announcement returns as well as positive long-run abnormal stock performance. The evidence of Chinese mergers is contradicted to the findings in US and UK, however, it is consistent with research of merger activities in global markets (Alexandridis et al. 2009).

Our study is closely related to previous event studies of political connections that market values of politically connected firm changes in response to news about market-wide political events (Claessens, Feijen and Laeven 2008, Cooper et al. 2010, Goldman, Rocholl and So 2009, Johnson and Mitton 2003). These studies show the value of firms increase (decrease) when their connected politician or party wins (loses) in the national election. They suggest that political connections would benefit firms linked to these politician or party through expected future favorable government treatment. However, the Chinese constitution guarantees the Communist Party as the only ruling party, so that political connected firms do not have to decide which party or politician to support. Hence, the political connected firms in China should always receive favorable government treatment.

Our study is also related to the literature about the impact of political connections in Chinese market (Berkman et al. 2009, Calomiris, Fisman and Wang 2010, Fan et al. 2007, Wu et al. 2010). Calomiris et al. (2010) examine the changes of stock prices at the announcement of selling state shares and cancelling the selling scheme. They find negative announcement effect to the first event and positive announcement effect to the latter one, which suggests that

⁶ "On February 27, 2007, Shanghai exchange index fell by 8.8% because a fear of government intervention on cooling down the stock market."--- Wall Street Journal, February 28, 2007.

the political connections outweigh the cost of inefficiency in China. Our research is also based on the event study, but we include the analysis in the long-term performance. Berkman et al. (2009) shows the new regulations are less effective for firms tied to government. Our finding is consistent that SOE firms tend to benefit more from new policies and regulations.

The remainder of this paper proceeds as follows. The data and methodology is outlined in Section 2. Section 3 reports univariate and multivariate tests, while operating performance and acquirer's characteristics are examined in Section 4. Finally, Section 5 concludes the paper.

2. Data and Methodology

2.1 Sample selection and data description

Our sample contains 825 successful merger deals of Chinese acquirers from June 1994 to November 2008 provided by the Thomason One Banker deals (SDC) database. Following Fuller et al. (2002), we select the mergers that meet the following criteria:

1. Acquirer is a Chinese firm listed in the Shanghai or Shenzhen stock exchange.
2. Acquirer's stock should have at least 100 trading days before the acquisition announcement and 1 year's performance afterwards.
3. Neither bidding nor target firms belong to financial or utility sectors.
4. Acquirers who made multiple attempts are excluded if the last merger deal is within one year window
5. Outliers with obvious flawed accounting ratios are dropped, including negative book value and book-to-market values exceeding 10.

We use the state ownership of listed companies as a proxy for political connections. Following Berkman et al. (2009), if the largest shareholder of a firm is the government agencies or government institutions, this firm is classified as a SOE with strong political connections. As noted by Chen et al. (2009) that legal person shares can be owned by SOEs as well as private firms, we do not use this type of share to identify firm's political ties. Chen et al. (2009) also report the median stake of largest shareholder is 42.6%, while the second largest block-holder owns only 5%. There is little chance that a firm whose second or third

largest shareholder is government would have the same strong political connections as SOEs. To prevent any biases of our proxy, the percentage of state ownership is used in the multivariate tests.

[INSERT TABLE I HERE]

Table I reports summary statistics of the main characteristics of all merger deals sorted by calendar year. The total number of deals and aggregate value of transaction increase dramatically after 2002, climbing up to 176 deals with \$8.67 billion transaction in 2008. The method of payment is dominated by stock payment (572), compared to cash payment (129) and mixed payment (124). In our sample, about 22.4% (185) of total merger deals are conducted by SOE acquirers, which is less than the number of POE acquirers (640). Wu et al.(2010) report that 64% of all firms in Shanghai and Shenzhen Exchanges are controlled by central or local government at year 2006. It seems that SOEs are less active in M&As market in the term of deal number. Deals by SOE acquirers are distributed evenly between SOE targets (92) and POE targets (93), while POE acquirers take over more POE targets (537) than SOE targets (103). From the table, the upward trend of merger deals relies on mergers among Private owned firms. One plausible reason is that assets of SOEs in China are under tight control of government agencies, such as the State Asset Management Bureaus (SAMBs) and SOEs Asset Supervision and Administration Commission (SASAC). According to Chapter 5 of State Owned Assets Law, transferring state assets to other non-government entity should be reported to the government for approval. So the barriers from legislation and bureaucrat may lower the possibility of completeness when a SOE is involved in the deal.

In panel B of Table I, the numbers of deals occurring in the top 7 industries are reported. We find that bidding companies are heavily concentrated in those hot investing and growing sectors during the sample period. For example, there are 107 mergers in chemical and allied products, covering 13% of all deals in the sample. Those top 7 industries altogether contribute a half of all acquisitions. Meanwhile, these industries are heavily, if not over, invested post-2000, partially caused by supports from China's policies of economic structure adjustments. In contrast to the starting stage of reform and openness when the government encouraged the fast development of manufacture industry in a rough way, the industrialization in China now enters an era of secondary production booming with eliminating or rebuilding small energy-consuming industrial companies. Both the heavy manufactory and the petrochemical industries get full political and financial help from the government, which

speeds up the development of economic scales and the adjustment of economic structure. The timing and scope of merger waves reflect a dominant effect of changes in political and economic environment on corporate financial decisions in the Chinese market.

2.2 Window of political events

To investigate the influence of political connection in M&A outcomes, we further classify our sample periods into hot political periods and cold political periods. The logic is that if different performance of SOE and POE acquirers is because of political connections, the difference would be even larger when political intervention is more intense and direct. We identify two types of political events in China. One is annual National People's Congress (NPC) and People's Political Consultative Conference (CPPCC), which are held at the beginning of March every year. NPC is the supreme organ of state according to the Chinese constitution. The functions of NPC include appointing officials of state organs, enacting or amending laws, and determining major state issues⁷. Procedurally, new bills and state plans for national economic and social development are briefed to relevant department or committee of NPC. During the annual meetings, NPC delegations first reviews the working reports presented by the primary minister and other high-ranking officials. Then, NPC delegations examine and discuss the new bills and state plans. Based on suggestions by delegations and other appropriate special committees, new bills and plans with amendment will be approved and adopted if a simple majority of all delegations vote for them. The major work of CPPCC is to explain new state plans and bills to other non-ruling parties. Apart from meetings of central states, the Local People's Congresses (LPC) across the provinces also gathered shortly before or after NPC. They perform the same duties with restricted authority. NPC, CPPCC, and LPC meetings are naturally top political events in China, which largely determine the way of the economic and social development in the following year. We define the hot political periods as one month around NPC meeting, covering the whole procedure of NPC and CPPCC, and roughly most of LPCs.

Another type of political events is adoption or amendment of acts and regulations that directly related to M&As⁸. These acts and regulations are approved by government departments such as SOE Asset Supervision and Administration Commission of the State Council (SASAC), China Securities Regulatory Commission (CSRC), instead of NPC or

⁷ See the introduction of NPC on <http://www.npc.gov.cn/englishnpc/Organization/>

⁸ See Appendix for regulations related to M&As.

other legislature. Calomiris et al. (2010) argue that Chinese government with firmly control of commerce and economics would be more willing to grab profits from private owned companies rather than SOEs. New regulations issued by government departments are found to treat SOEs and POEs discriminately, enforcing more restriction on POEs (Beckman et al. 2009). It is likely that new regulations of M&As may curb on POE acquirer with more restrictions, and create competitive advantage for SOE acquirers. We identify ten regulations directly related to M&As during our sample periods, and classify one month around the announcement date of new regulations as hot political periods. The remaining months within our sample are defined as “cold” political periods.

2.3 Measure of short and long run abnormal returns

Stock price data are obtained from Thomason-Reuters DataStream. We use the Price Index (PI) data type for daily return and Return Index (RI) data type for monthly intervals⁹. To test market reaction to merger announcement, we follow Brown and Warner (1985) using modified market model to estimate daily abnormal returns, which is daily acquirer’s return minus value-weighted stock returns of Shanghai and Shenzhen stock exchange. We sum up abnormal returns within 5-day around merger announcement (-2,+2)¹⁰ as:

$$CAR_{it} = \sum_{t-2}^{t+2} (R_{i,t} - R_{M,t}) \quad (1)$$

where $R_{i,t}$ is individual firm i 's return at day t , and $R_{M,t}$ is Shanghai and Shenzhen value-weighted stock returns at day t . The similar results are obtained if using equally weighted stock returns.

Following Lyon et al. (1999) we use buy-and-hold abnormal returns (BHARs) to assess the long-run performance of mergers over 2 years. As suggested by Lyon, et al. (1999), we construct reference portfolio instead of using market portfolio as benchmark. The returns of reference portfolio $R_{ref,T}$ are calculated as:

$$R_{ref,T} = \sum_{i=1}^{n_s} \frac{\left[\prod_{t=s}^{s+T} (1 + R_{i,t}) \right] - 1}{n_s} \quad (2)$$

⁹ DataStream provide daily stock price index based on business day of United Kingdom. So we exclude returns of those non-trading days in Chinese stock market due to time difference. The price index is adjusted for stock splits, and return index is adjusted for both splits and dividend payment.

¹⁰ Our results are robust to different event windows, including 3 days (-1, +1), 11 days (-5, +5), which is available upon request

where $R_{i,t}$ is arithmetic return of stock i at month t , n_s is number of stocks in the portfolio at the beginning month of s , T is the length of holding periods. Notably, because of Special Treatment (ST) policy that keeps distressed firms in Chinese stock exchanges, the number of delisted stocks is only 43, quite small compared to over 1600 listed companies. The BHAR of each acquirer is calculated over 2 years after merger:

$$BHAR_i = \prod_{t=s}^{s+T} (1 + R_{i,t}) - R_{ref,T} - 1 \quad (3)$$

where $R_{i,t}$ is acquirer i 's simple return at month t , and $R_{ref,t}$ is reference portfolio's return over the holding periods T .

2.4 Multivariate Regression on CARs and BHARs

To assure that the findings in CARs and BHARs are robust, we further run OLS regressions with control of other factors that may influence the announcement effect and post-merger performance. The main regression is as following:

$$\begin{aligned} CARs \text{ or } BHARs = & c + \alpha_1 SOEAcquirerDummy + \alpha_2 SOETargetDummy \\ & + \alpha_3 SOEAcquirerDummy \times SOETargetDummy \\ & + \alpha_4 SOEAcquirerDummy \times HotPolDummy \\ & + \alpha_5 SOETargetDummy \times HotPolDummy \\ & + \beta_1 CashDummy + \beta_2 StockDummy + \beta_3 DiversifyDummy \\ & + \beta_4 \log RelativeSize + \beta_5 LogAsset + \beta_6 Leverage + \beta_7 Market/Book \\ & + \sum \gamma_i IndustryDummy + \sum \delta_j YearDummy \end{aligned} \quad (3)$$

where $SOEAcquirerDummy$, $SOETargetDummy$ equals one if the acquirer or target is SOE firm, respectively; $HotPolDummy$ equals one if the merger is announced during hot political periods. We also use three interaction terms among acquirer, target, and political period, to capture the relation between political connections and political influence. Empirical evidence in previous literature shows that method of payment has predictable power of merger performance (Loughran and Vijh 1997). Impact of method of payment is estimated by $CashDummy$ ($StockDummy$), which takes the value of one if the method of payment is cash (stock). $DiversifyDummy$ equals one if the first 2-digit standard industry classification code of acquirer is different from that of the target firm. Relative size is another well documented factor in acquirer's performance (Moeller et al. 2004). Hence, we include $LogRelativeSize$, calculated as logarithm of transaction value divided by total asset of acquirer at the one fiscal year before merger announcement. Acquirer's size is captured by $LogAsset$, which is

logarithm of acquirer's asset at the last fiscal year before acquisition. Leverage is the long term debt divided by total asset, while Market/Book is the market value of acquirer's stock at the last trading day one year prior to merger deal divided by book equity value in last fiscal year. Follow Bouwman et al. (2009), year dummies and industry dummies are included to control for year effect and industry effect.

3. Results of Univariate Test and Multivariate Regressions

3.1 Univariate Test of Announcement Effect

[INSERT TABLE II HERE]

Table III reports acquirers' CARs within 5-day window of merger announcement. In panel A, we find that the announcement effect is significantly positive with 0.83% over the whole sample. SOE acquirers generate insignificant positive 0.7% abnormal returns, which is less than POE acquirers with significant positive performance of 0.87%. When we split targets, acquirers have much better performance if target is SOE (significant 1.36%) compared to POE targets (0.67%). POE acquirers generate even higher announcement returns when they merge SOE targets (2.49%). In the contrary, announcement effect is greater for SOE acquirers when the target is POE (1.13%), compared to merging another SOE target (0.25%). The results show that investors have different perceptions of mergers between SOEs and POEs. Market responds positively more to mergers by POE acquirers, while SOE firms seem to be better targets. These results may reveal the value of political connections that POEs gain through merging SOE targets, while political connection is less valuable to SOEs acquirers as they already have.

Panel B shows the acquirers' announcement effect during hot political periods as classified in section 2.3. All acquisitions within this sub-sample perform as well as those in the whole sample. However, the announcement effect of SOE acquirers is significant positive of 1.03%, greater than POE acquirers (0.86%). Moreover, performance of acquirers taking over SOE targets (2.47%) is much better than those taking over POE targets (0.46%). The announcement effect of SOEs taking over POEs is significantly positive as well. Compare to the acquisitions within whole sample, these results indicate that market is more welcoming of SOE-related mergers during the hot political periods. The POE acquirers taking over SOE targets during this period enjoy the highest short-run announcement performance (4.27%)

among other groups. We argue that the more government or political interference, the higher valuation of political connections.

The results in panel C during cold political periods show slightly lower announcement abnormal returns of all acquirers (0.78%). The announcement effect of cold-political acquisitions with SOE targets is insignificant 0.7%, less than those with POE targets (significant 0.87%). Compared to panel A and B, SOEs seem to be less valuable targets when political intervention is relatively weak. Also, during cold political periods, SOE acquirers taking over SOE targets generate negatively insignificant CARs of -0.04%, suggesting that such deals have no effect on market valuation of SOE acquirers.

In summary, it is evident that merger outcomes are affected by political connections that acquirers taking over SOE targets have higher short-run abnormal returns than those taking over POE targets. The SOE-related mergers experience higher announcement abnormal returns during hot political periods. It seems that the market prefers mergers with political connections when political intervention is intense. When taking over SOE targets, POE acquirers rather than SOE acquirers have positively significant CARs, indicating that political connections add value to POE firms. These results show that the value of political connections is positive to the firms, and changes with the magnitude of political intervention.

3.2 Univariate Test of Long-Run Stock Performance

[INSERT TABLE III HERE]

Table IV presents the 2-year BHARs of acquirers after merger announcement. In panel A, the long-run performance of all acquisitions is significantly positive of 23.36%. Mergers seem to create value for acquirers in China rather than to destroy values in US or UK. SOE acquirers have slightly higher BHARs (24.59%) than POE acquirers (16.91%). Acquirers taking over SOEs (32.23%) experience better performance than those taking over POEs (20.61%), which is consistent with the results from announcement effect. However, in contrast to stock market reaction at announcement date, the long-run performance of SOE acquirers taking over another SOE is significantly positive of 43.04%, suggesting that market under-estimates the value of these mergers.

Panel B and panel C split the sample into hot and cold political periods based on the date of merger announcement. In panel B, SOE acquirers experience significantly higher long-run performance 44.75%, when they conduct mergers during hot political periods. Also,

we find that acquirers taking over SOE targets have much higher BHARs of 45.14%, compared to those taking over POE targets (15.26%). However, the outperformance of acquisitions with SOE targets is concentrated in SOE acquirers with significant 68.05%, while POE acquirers have insignificant negative BHARs of -5.32%. This evidence is consistent with the previous literature¹¹ that government may grab profits from private firms and benefit politically connected firms by means of enacting new industrial regulations, carrying out state plans in favor of connected firms. Moreover, the superior long-run performance of mergers that both acquirers and targets are SOEs, may be attributed to the political influence in both firms. Chong et al. (2006) report that forced bank mergers in Malaysia create values for acquirer at the cost of targets. Compared to POE targets, it may be much easier for government to persuade SOE targets to accept the merger offers. As emphasized by Li Rongrong, head of SASAC, that SOEs are aimed to be ‘superstars’. To achieve that goal, SASAC reform the SOEs by restructuring and acquisitions. It is likely that outperformance of mergers between SOEs is positively related to government interference.

Comparing to panel B, SOE acquirers during cold political periods have insignificant BHAR of 8.65%, much less than POE acquirers (significant 29.01%). With less strong political interference, the long-run performance of SOE-related mergers during cold political periods (0.68%) is far worse than the performance during hot political periods (68.05%). The results further confirm the value of political connections is positively related to government intervention in Chinese market. In addition, it is notable that POEs acquiring SOE or POE targets have much better post-merger performance, with 36.64% and 25.43% respectively, during cold political periods. Combining the results in panel B, the results suggest a negative role of political influence in POE mergers, which supports the view of government grasping profits from those firms without political connections.

In short, the evidence shows SOE acquirers have much better long-run performance during hot political periods. Mergers between SOEs during hot political periods have highest 2-year BHARs. We argue that political influence has a positive (negative) role in connected (un-connected) mergers. The value of political connections is higher when government intervention is more intense.

3.3 Multivariate Regression

¹¹ See for example Frye and Shleifer (1997)

[INSERT TABLE IV HERE]

Panel A of Table V reports the results of multivariate regression on 5-day CARs. In Column 1, we find that coefficients on the SOE acquirer dummy is insignificant positive (0.91%), while SOE targets has significantly positive coefficient of 1.89%. This is consistent with univariate test of announcement effect that acquirers taking over SOE firms have higher CARs compared to those taking over POE firms. SOE acquirers taking over SOEs have a significantly negative coefficient -2.53%. Investors seem to believe that such deal between SOEs will destroy acquirer's value. The lower valuation of mergers between SOEs is even worse during hot political periods (-4.46% in column 2). Moreover, all coefficients of SOE related dummies are more (less) significant during hot (cold) political periods, suggesting a robust role of political impact on the value of SOE-related mergers. Consistent with Loughran and Vijh (1997), stock mergers have significant negative announcement effect (-6.64%). Relative size of target to acquirer's value is positively related to CARs (2.48%), especially during hot political periods (10.79%). CARs are significantly higher for acquirers with higher market to book ratio (3.8%), which is consistent with previous literature (Bouwman, Fuller and Nain 2009).

Regression on 2-year BHARs is presented in Panel B. The long-run performance of SOE acquirers is significantly higher than POE acquirers (5.14%). However, as the results of univariate tests, BHARs of SOE acquirers are much higher during hot periods (48.06%). The results further confirm that outperformance of SOE acquirers is because of political influence. Acquisitions of SOE targets experience better long-run performance for SOE acquirers (52.84%) during hot political periods. In contrast, acquisitions between SOEs suffers significant -43.28% BHARs during cold political periods. These results show that value of political connections is higher (lower) under intense (loose) government intervention. Method of payment seems to have no relation with acquirer's long-run performance. We also find that larger acquirers in terms of total asset tend to have higher BHARs (17.73%). Firm's valuation (Market/Book) is negatively related to long-run performance (-16.0%). Overall, the regression results are consistent with the findings in the univariate tests as well as previous literature of determinants of merger outcomes.

4. Operating Performance and Acquirer's Characteristics

In the previous section, we find that SOE acquirers outperform POEs in the long-run. To analyze the reason behind it, we compare the operating performance between SOE and POE acquirers.

4.1 Operating Performance

Follow Healy et al. (1992), we use operating cash flow return (OCFR) to capture the acquirer's operating performance. As Healy et al. (1992) argue that this measure is less affected by accounting method and the method of payment. Operating cash flow is calculated as sales minus cost of goods sold plus depreciation. We scale the operating cash flow by firm's market value of asset, which is market value of equity at the last trading day prior to merger announcement plus book value of debt. To ensure the operating cash flow return is not biased of mean revering profitability, we further use industry median OCFR to adjust acquirer's performance. The industry is classified according to first 2-digit SIC codes. So the main measure used below is adjusted operating cash flow return (AOCFR), calculated as acquirer's OCFR minus industry median value¹².

[INSERT TABLE V HERE]

Table VI shows the median of AOCFR two years after merger announcement. The overall sample has insignificantly higher operating performance than industry average (0.04%). The median of SOE acquirers has significant positive AOCFR of 0.37%, while the median of acquirers taking over SOEs underperform the industry average by -0.58%. The evidence indicates that SOE acquirers have more profitability than POE acquirers, which is consistent with the results of long-run stock performance. POE firms acquiring SOEs have the lowest AOCFR (-1.56%). Combining the positive announcement effect and negative long-run performance, it seems investors over-estimate the value of SOE target after merge. Although POE acquirers could gain the value of political connections through merging SOEs, the shadow cost of inefficiency may outweigh the gain. Chong et al. (2006) argue that acquirers in Malaysian forced bank mergers tend to gain through the loss of targets. Chinese POE acquirers may be worse off under the pressure of political influence. To successfully acquire a SOE, POE firms may be required to offer excess employment for existing labors in target firm.

¹² If the number of firms in the sub-industry is less than 5, we search for firms that their total asset value is between 90% - 110% of acquirer's asset. Then median value of these matched firms is used to adjust acquirer's OCFR.

4.2 Change of Operating Characteristics

Following Healy et al. (1992), we decompose the operating cash flow return into operating cash flow margin (OCFM) and asset turnover. OCFM is the operating cash flow over sales, capturing the unit profit of sales. Asset turnover calculated as sales over total assets. OCFM shows the profitability of firm's products or business, while asset turnover measures the firm's efficiency of using its assets. Moreover, we also include the measure of relative employment rate, as employment is one important objective to SOE firms other than POEs. We use asset/employment and sales/employment to measure employment productivities. We also assume that an over-employment firm will have a lower asset/employment ratio. All estimates are adjusted by the median value of industries assigned by first 2-digit SIC code.

[INSERT TABLE VI HERE]

We report the change of operating characteristics adjusted by industry average in Table VII. To avoid the biases at the year of merge, we show the change of operating characteristics through one year before and two years after merger. Panel A shows that operating cash flow margin increase at year one but decrease at year two. The SOE firms have persistently larger operating margin than POEs pre- and post merger, which is consistent with Chen et al. (2008). The acquirers tend to use their asset more productively after merger. The industry median adjusted asset turnover of all sample increase from -2.74% to 0.02%. It is notable that the improvement of asset productivity is attributed to POE acquirers from -.278% to 1.50%, while SOE acquirers have no significant change. The outperformance of SOE acquirers is largely due to their high operating margin, which is partially offset by the inefficiency of asset usage.

Asset/employment shows a significant increase after merger for SOE acquirers, while POE firms are have lower asset value per employee. Chen et al. (2008) report that SOE firms hire more employees than POE firms. Our evidence suggests that SOEs rely on larger asset value per capita to sustain their employment, which seems to be inefficient compared to less cost of asset per capita in POE firms. Sales/employment is higher for SOE firms than POE firms, which is likely due to more asset per capita SOE firm use.

4.3 Change of Investment Characteristics

Political connected firms are found to receive more financial support from government (Allen, Bernardo and Welch 2000, Faccio et al. 2006, Johnson and Mitton 2003). In Chinese merger market, a special 5-year annexation loans provided by the state banks are aimed to help SOE reform and restructure. These loans can lower the cost of merger financing, however, POE firms can hardly access to. As argued by Ayyagari et al. (2010), the bank financing is critical to firm's operations, the superior merger performance of SOE may be related to their advantage to bank financing.

We further examine the change of firm's investment characteristics other than operating performance. We use debt ratio and quick ratio to measure firm's financial health. Debt ratio is book value of the long-term debt divided by market value of equity at last trading day of year before merger. Quick ratio is cash and cash equivalent over current debt. Meanwhile, we use capital expenditure over total asset to measure investment policy of acquirers¹³. Capital investment may also real the financial conditions, as it is positively related to firm's free cash flows.

[INSERT TABLE VII HERE]

From Table VIII panel A, we find that the industry-adjusted debt ratio of SOE acquirers is higher than POE acquirers both pre- and post-merger. The median adjusted debt ratio of SOEs is -4.12% and -2.02% at year one and two after merger, lower than industry average level. The result suggests that SOEs raise less debt to financing merger. The quick ratio of SOE acquirers is also higher than POEs. The change of quick ratio between pre-and post-merger is 0.41% for SOEs and -2.44% for POEs. It seems that POEs pay more cash to targets. In addition, the capital expenditure of SOE acquirers (0.42%) is slightly higher than industry and POE counterparts (0.20%). These results show that SOE acquirers save more cash, spend more investment, but have lower leverage ratio. Consistent with Healy et al. (1992), the capital expenditure seems to increase instead of decrease. These results show that SOE acquirers have more financial resources, which may receive from government support.

In summary, the evidence shows that long-run outperformance of SOE acquirers are attribute to higher productivity margins, other than asset productivity. SOE acquirers have higher asset value per capita, lower debt ratio, higher quick ratio, and higher ratio of capital

¹³ We do not use R&D because a very low portion of Chinese companies report R&D value in financial reports.

expenditure compared to industry average, suggesting that government may transfer wealth to these connected firms.

5. Conclusion

This paper examines the role of political connections and government intervention in Chinese merger market. We find that announcement effect is positively associated with SOE targets, while SOE acquirers experience higher long-run stock performance. Moreover, political events, including NPC and announcement of new M&A regulations, have significant impact on merger outcomes. During hot political periods, SOE-related merger deals receive more positive market reactions in the short run, and generate higher long-run abnormal returns. Further investigation shows that SOE acquirers are more profitable because of higher operating cash flow margin, lower debt ratio, and more cash reserve. Also, SOEs seem to obtain relatively more asset than POEs.

Our findings indicate that value of political connections is positive in the Chinese M&A market. Political connected firms may obtain more benefits when government intervention is more intense and direct. We also show that NPC and CPPCC have significant impact in Chinese market due to its unique institutional settings.

Table I Summary Statistics

This table summarizes the main characteristics of merger deals in our sample. The sample consists of 825 successful merger deals in Chinese market from 1994 to 2008, where all acquirers are listed companies in Shanghai and Shenzhen Stock Exchanges. In panel A, we categorize merger activities according to method of payment, cash payment refers to the deals that 100% financed by cash; stock payment refers to the deals that 100% financed by stock; mixed payment refers to the deals that financed by both cash and stocks. Acquirer and targets are classified into state owned enterprises (SOE) and private owned

enterprises (POE). Panel B reports the number and proportion of mergers in top 7 industry sectors, identified by first 2-digit SIC code. Value of transaction is denominated in 1 million USD.

| Panel A | | | Method of payment | | | SOE Acquirer | | POE Acquirer | |
|---------|------------|----------------------|-------------------|---------------|---------------|--------------|------------|--------------|------------|
| Year | All sample | Value of Transaction | cash payment | stock payment | mixed payment | SOE Target | POE Target | SOE Target | POE Target |
| 1994 | 3 | 3.04 | 1 | 1 | 1 | 0 | 1 | 0 | 2 |
| 1995 | 6 | 160.1 | 0 | 5 | 1 | 0 | 1 | 0 | 5 |
| 1996 | 14 | 20.79 | 1 | 7 | 6 | 0 | 5 | 4 | 5 |
| 1997 | 11 | 79.89 | 0 | 10 | 1 | 2 | 1 | 0 | 8 |
| 1998 | 12 | 244.4 | 3 | 8 | 1 | 3 | 4 | 1 | 4 |
| 1999 | 7 | 93.82 | 2 | 4 | 1 | 1 | 2 | 0 | 4 |
| 2000 | 15 | 648.5 | 3 | 12 | 0 | 1 | 4 | 1 | 9 |
| 2001 | 17 | 2634.2 | 2 | 16 | 0 | 2 | 3 | 1 | 11 |
| 2002 | 48 | 1110.6 | 6 | 39 | 3 | 4 | 6 | 5 | 33 |
| 2003 | 105 | 2307.6 | 17 | 78 | 10 | 10 | 18 | 19 | 58 |
| 2004 | 109 | 3804.7 | 24 | 78 | 7 | 14 | 12 | 8 | 75 |
| 2005 | 74 | 829.2 | 18 | 52 | 4 | 13 | 11 | 8 | 42 |
| 2006 | 80 | 5487.4 | 12 | 59 | 9 | 11 | 8 | 6 | 55 |
| 2007 | 148 | 17472.9 | 18 | 107 | 23 | 16 | 7 | 17 | 108 |
| 2008 | 176 | 8677.55 | 22 | 96 | 58 | 15 | 10 | 33 | 118 |
| SUM | 825 | 43574.8 | 129 | 572 | 124 | 92 | 93 | 103 | 537 |

| Panel B | | | |
|-------------|------------|------------------|---|
| no. of M&As | Percentage | 2-digit sic code | Industry sector |
| 107 | 13% | 28 | Chemicals and Allied Products |
| 82 | 10% | 36 | Electronic, Electrical Equipment & Components, Excpt Computer Equipment |
| 60 | 7.20% | 35 | Industrial and Commercial Machinery and Computer Equipment |
| 51 | 6.30% | 65 | Real Estate |
| 50 | 6.10% | 33 | Primary Metal Industries |
| 40 | 4.90% | 20 | Food and Kindred Products |
| 29 | 3.60% | 22 | Textile Mill Products |
| 419 | 49% | -- | Other Industries |

Table II 5-day CARs

This table reports 5-day CARs for all acquirers at announcement day during hot political and cold political periods. Political events include annual NPC and CPPCC meetings, and announcement of new M&As regulations. Hot political periods are one month around these political events. SOE and POE are state-owned enterprises and private-owned enterprise, respectively. The sample includes all M&A deals where acquirers are listed companies in Chinese market from SDC database during 1994 -2008. ***,**,* represent the significant of average return different from zero, at 1%, 5% and 10% level, respectively, based on one-tail student t test.

| Panel A: All sample | | | | | | |
|--------------------------------|-------------|----------|------------|---------|------------|----------|
| | All Targets | | SOE Target | | POE Target | |
| | Mean | | Mean | | Mean | |
| All Acquirer | Mean | 0.83%*** | Mean | 1.36%** | Mean | 0.67%*** |
| | T-value | (3.45) | T-value | (2.25) | T-value | (2.64) |
| | Number | 825 | Number | 295 | Number | 630 |
| SOE Acquirer | Mean | 0.70% | Mean | 0.25% | Mean | 0.59%** |
| | T-value | (1.6) | T-value | (0.35) | T-value | (2.29) |
| | Number | 185 | Number | 92 | Number | 93 |
| POE Acquirer | Mean | 0.87%*** | Mean | 2.49%** | Mean | 0.87%*** |
| | T-value | (3.06) | T-value | (2.59) | T-value | (3.06) |
| | Number | 640 | Number | 203 | Number | 537 |
| Panel B: Hot Political Periods | | | | | | |
| | All Targets | | SOE Target | | POE Target | |
| | Mean | | Mean | | Mean | |
| All Acquirer | Mean | 0.90%** | Mean | 2.47%** | Mean | 0.46% |
| | T-value | (2.31) | T-value | (2.31) | T-value | (1.15) |
| | Number | 348 | Number | 105 | Number | 243 |
| SOE Acquirer | Mean | 1.03%** | Mean | 0.73% | Mean | 1.28%* |
| | T-value | (2.02) | T-value | (0.95) | T-value | (1.87) |
| | Number | 101 | Number | 47 | Number | 54 |
| POE Acquirer | Mean | 0.86%* | Mean | 4.27%** | Mean | 0.29% |
| | T-value | (1.75) | T-value | (2.15) | T-value | (0.63) |
| | Number | 247 | Number | 58 | Number | 189 |
| Panel C Cold Political Window | | | | | | |
| | All Targets | | SOE Target | | POE Target | |
| | Mean | | Mean | | Mean | |
| All Acquirer | Mean | 0.78%** | Mean | 0.7% | Mean | 0.81%** |
| | T-value | (2.58) | T-value | (0.97) | T-value | (2.43) |
| | Number | 477 | Number | 190 | Number | 387 |
| SOE Acquirer | Mean | 0.47% | Mean | -0.04% | Mean | 1.13%** |
| | T-value | (0.73) | T-value | (-0.04) | T-value | (2.29) |
| | Number | 84 | Number | 45 | Number | 39 |
| POE Acquirer | Mean | 0.87%** | Mean | 1.45% | Mean | 0.78%** |
| | T-value | (2.52) | T-value | (1.48) | T-value | (2.1) |
| | Number | 393 | Number | 145 | Number | 348 |

Table III 2-year BHARs

This table reports 2-year BHARs for all acquirers after announcement day during hot political and cold political periods. Political events include annual NPC and CPPCC meetings, and announcement of new M&As regulations. Hot political periods are one month around these political events. SOE and POE are state-owned enterprises and private-owned enterprise, respectively. The sample includes all M&A deals where acquirers are listed companies in Chinese market from SDC database during 1994 -2008. ***,**,* represent the significant of average return different from zero, at 1%, 5% and 10% level, respectively, based on one-tail student t test.

| Panel A: All sample | | | | | | |
|-------------------------------|-------------|--------|-------------|--------|------------|--------|
| | All Targets | | SOE Targets | | POE Target | |
| | Mean | | Mean | | Mean | |
| All Acquirer | 23.36%*** | (3.87) | 32.23%** | (2.34) | 20.61%*** | (3.09) |
| | 811 | | 289 | | 622 | |
| SOE Acquirer | 24.59%** | (2.52) | 43.04%** | (2.01) | 17.45% | (1.51) |
| | 180 | | 87 | | 93 | |
| POE Acquirer | 16.91%*** | (3.08) | 11.36% | (1.39) | 21.35%*** | (2.74) |
| | 631 | | 202 | | 529 | |
| Panel B Hot Political Window | | | | | | |
| | All Targets | | SOE Target | | POE Target | |
| | Mean | | Mean | | Mean | |
| All Acquirer | 22.06%*** | (2.85) | 45.14%** | (2.21) | 15.26%* | (1.92) |
| | 340 | | 103 | | 237 | |
| SOE Acquirer | 44.75%*** | (2.8) | 68.05%** | (2.46) | 19.21% | (1.46) |
| | 97 | | 47 | | 50 | |
| POE Acquirer | 11.51% | (1.37) | -5.32% | (-0.6) | 14.06% | (1.47) |
| | 243 | | 56 | | 187 | |
| Panel C Cold Political Window | | | | | | |
| | All Targets | | SOE Target | | POE Target | |
| | Mean | | Mean | | Mean | |
| All Acquirer | 24.14%*** | (2.85) | 25.01% | (1.37) | 23.86%** | (2.49) |
| | 471 | | 68 | | 385 | |
| SOE Acquirer | 8.65% | (0.73) | 0.68% | (0.05) | 15.93% | (0.87) |
| | 83 | | 40 | | 43 | |
| POE Acquirer | 29.01%*** | (2.77) | 36.64% | (1.48) | 25.43%** | (2.34) |
| | 388 | | 146 | | 342 | |

TABLE IV OLS Regression on CARs and BHARs

This table reports OLS multivariate regression on 5-day CARs and 2-year BHARs as follows:

$$\begin{aligned}
 CARs \text{ or } BHARs = & c + \alpha_1 SOEAcquirerDummy + \alpha_2 SOETargetDummy \\
 & + \alpha_3 SOEAcquirerDummy \times SOETargetDummy \\
 & + \alpha_4 SOEAcquirerDummy \times HotPolDummy \\
 & + \alpha_5 SOETargetDummy \times HotPolDummy \\
 & + \beta_1 CashDummy + \beta_2 StockDummy + \beta_3 DiversifyDummy \\
 & + \beta_4 \log RelativeSize + \beta_5 LogAsset + \beta_6 Leverage + \beta_7 Market/Book \\
 & + \sum \gamma_i IndustryDummy + \sum \delta_j YearDummy \tag{4}
 \end{aligned}$$

where SOEAcquirerDummy, SOETargetDummy equals one if the acquirer or target is a SOE firm, respectively; HotPolDummy equals one if the merger is announced during hot political periods. Three interaction terms are constructed by acquirer dummy, target dummy, and political period dummy. CashDummy (StockDummy) takes the value of one if the method of payment is cash (stock). DiversifyDummy equals one if the first 2-digit standard industry classification code of acquirer is different from that of the target firm. Relative size (LogRelativeSize), calculated as logarithm of transaction value divided by total asset of acquirer at the one fiscal year before merger announcement. Acquirer's size (LogAsset) is the logarithm of acquirer's asset at the last fiscal year before acquisition. Leverage is the long term debt divided by total asset, while Market/Book is the market value of acquirer's stock at the last trading day one year prior to merger deal divided by book equity value in last fiscal year. Year dummies and industry dummies are included in the regression, but not reported to save space. The sample includes all M&A deals where acquirers are listed companies in Chinese market from SDC database during 1994 -2008. ***,**,* represent the significant of average return different from zero, at 1%, 5% and 10% level, respectively, based on one-tail student t test.

| | Panel A: Dependent Variable is CARs | | | Panel B: Dependent Variable is BHARs | | |
|-----------------------------------|-------------------------------------|----------------------|-----------------------|--------------------------------------|----------------------|-----------------------|
| | All Sample | Hot Political period | Cold Political Period | All Sample | Hot Political period | Cold Political Period |
| | [1] | [2] | [3] | [4] | [5] | [6] |
| Intercept | 0.43% | 7.72% | -3.83% | -2.68% | -2.90% | -2.07% |
| | (0.13) | (1.38) | (-0.92) | (-1.19) | (1.05) | (-1.42) |
| SOEAcquirerDummy | 0.91% | 1.76%*** | 0.17% | 5.14%* | 9.59% | -4.55% |
| | (0.89) | (-2.36) | (0.15) | (1.91) | (-0.38) | (-0.14) |
| SOETargetDummy | 1.89%** | 4.06%*** | 0.37% | 6.32% | -35.16% | 23.92% |
| | (2.13) | (2.89) | (0.35) | (0.25) | (-1.04) | (0.8) |
| SOEAcquirerDummy x SOETargetDummy | -2.53% | -4.46% | -1.37% | 8.53% | 52.84%*** | -43.28% |
| | (-1.84) | (-2.05) | (-0.76) | (0.23) | (2.44) | (-1.23) |
| SOEAcquirerDummy x HotPolDummy | -0.33% | | | 48.06% | | |
| | (-0.25) | | | (1.47) | | |
| SOETargetDummy x HotPolDummy | 1.77%* | | | 3.09% | | |
| | (1.86) | | | (0.09) | | |
| CashDummy | 0.19% | -0.28% | 0.30% | -16.14% | 7.81% | -32.09% |
| | (0.26) | (-0.21) | (0.36) | (-0.83) | (0.26) | (-1.27) |
| StockDummy | -6.64%*** | -5.87%*** | -7.74%*** | -23.60% | -34.08% | |
| | (-4.92) | (-3.01) | (-4.06) | (-0.55) | (-0.55) | |
| DiversifiedDummy | 0.52% | 0.87% | 0.31% | -15.41% | -5.36% | -25.90% |
| | (0.98) | (0.98) | (0.47) | (-1.04) | (-0.28) | (-1.27) |
| LogRelSize | 2.48%* | 10.79% | -5.27% | -0.97% | -5.97% | 5.28% |
| | (2.14) | (2.67) | (-0.92) | (-0.18) | (-0.66) | (0.78) |
| LogSize | -0.01% | -0.58% | 0.32% | 17.73%*** | 21.78%** | 14.82% |
| | (-0.03) | (-1.52) | (1.12) | (2.35) | (2.19) | (1.4) |
| Leverage | -0.83% | -0.30% | -1.02% | 34.21% | 7.27% | 87.12% |
| | (-0.99) | (-0.18) | (-1.01) | (1.01) | (0.22) | (1.43) |
| Maret/Book | 3.8%* | 3.1%** | 3.9%*** | -16.0%* | -17.5%* | -18.6%* |
| | (1.72) | (2.26) | (3.33) | (-1.65) | (-1.71) | (-1.77) |
| F-Statistics | 3.6 | 2.96 | 2.41 | 1.44 | 2.08 | 1.74 |
| Adj-R2 | 4.42% | 6.83% | 3.08% | 1.17% | 6.07% | 2.17% |

Table V Operating Performance of Acquirers

This table reports the acquirer's adjusted operating cash flow returns two years after merger. Operating cash flow return is calculated as sales minus cost of goods sold plus depreciation divided by firm's market value of asset. We use industry median OCFR to adjust acquirer's performance. The industry is classified according to first 2-digit SIC codes. The adjusted operating cash flow return (AOCFR), calculated as acquirer's OCFR minus industry median value. The sample includes all M&A deals where acquirers are listed companies in Chinese market from SDC database during 1994 -2008. Z-statistics is reported in Parenthesis. ***,**,* represent the significant of average return different from zero, at 1%, 5% and 10% level, respectively, based on Wilcoxon-Mann-Whitney test.

| | All Target | | SOE Target | | POE Target | |
|---------------|------------|---------|------------|----------|------------|--------|
| All Acquirers | Median | 0.04% | Median | -0.58%* | Median | 0.04% |
| | Z-stat | (0.09) | Z-stat | (-1.58) | Z-stat | (0.26) |
| | Number | 557 | Number | 130 | Number | 427 |
| SOE Acquirer | Median | 0.37% | Median | 0.46%* | Median | 0.24% |
| | Z-stat | (1.42) | Z-stat | (1.72) | Z-stat | (0.76) |
| | Number | 133 | Number | 69 | Number | 64 |
| POE Acquirer | Median | -0.15% | Median | -1.56%** | Median | 0.1% |
| | Z-stat | (-0.25) | Z-stat | (-2.35) | Z-stat | (0.16) |
| | Number | 424 | Number | 61 | Number | 363 |

Table VI Change of Firm Characteristics

This table reports operating margin, asset turnover, sales over employment, and asset over employment from one year pre-merger to two years post-merger. Operating margin is operating cash flow over sales. Asset turnover calculated as sales over total assets. ASSET/EMPL is total value of asset divided by number of employees, and SALES/EMPL is Sales over number of employees. All estimates are adjusted by the median value of industries assigned by first 2-digit SIC code. The sample includes all M&A deals where acquirers are listed companies in Chinese market from SDC database during 1994 -2008.

| | Firm Median | | | Industry-adjusted Median | | |
|------------------|-------------|---------|---------|--------------------------|--------|--------|
| | Year -1 | Year 1 | Year 2 | Year -1 | Year 1 | Year 2 |
| Operating Margin | | | | | | |
| all | 12.69% | 12.39% | 11.58% | 0.23% | 0.63% | 0.70% |
| SOE Acquirer | 15.31% | 15.89% | 15.22% | 1.54% | 2.47% | 1.52% |
| POE Acquirer | 12.17% | 11.77% | 10.70% | 0.00% | 0.10% | -0.58% |
| Asset Turnover | | | | | | |
| all | 2.96 | 2.14 | 2.07 | -2.74% | 0.55% | 0.00% |
| SOE Acquirer | 2.95 | 2.18 | 2.20 | -2.10% | -0.90% | -1.49% |
| POE Acquirer | 2.96 | 3.13 | 3.00 | -2.78% | 1.27% | 1.50% |
| ASSET/EMPL | | | | | | |
| all | 1015.3 | 1184.3 | 1341.49 | 75.46 | 108.15 | 120.48 |
| SOE Acquirer | 1220.57 | 1862.51 | 1978.58 | 136.72 | 399.67 | 313.47 |
| POE Acquirer | 990.76 | 1111.99 | 1192.45 | 67.13 | 37.94 | 50.4 |
| SALES/EMPL | | | | | | |
| all | 553.66 | 685.48 | 717.66 | 61.53 | 83.78 | 98.33 |
| SOE Acquirer | 633.54 | 886.02 | 832.15 | 97.97 | 202.17 | 134.15 |
| POE Acquirer | 535.02 | 622.55 | 662.26 | 55.48 | 60.66 | 85.79 |

TABLE VII Change of Investment Characteristics

This table reports debt ratio, cash ratio, and capital expenditure ratio from one year pre-merger to two years post-merger. Debt ratio is book value of total debt over total asset. Cash ratio is cash or cash equivalent divided by current liability. Capital expenditure rate is capital expenditure over total asset. All estimates are adjusted by the median value of industries assigned by first 2-digit SIC code. The sample includes all M&A deals where acquirers are listed companies in Chinese market from SDC database during 1994 -2008.

| | Firm Median | | | Industry-Adjusted Median | | |
|---------------------------------|-------------|--------|--------|--------------------------|--------|--------|
| | Year -1 | Year 1 | Year 2 | Year -1 | Year 1 | Year 2 |
| <u>Debt Ratio</u> | | | | | | |
| all | 30.32% | 48.66% | 46.03% | -5.77% | -1.03% | 0.12% |
| SOE Acquirer | 27.94% | 46.53% | 36.35% | -7.61% | -4.12% | -2.02% |
| POE Acquirer | 31.40% | 48.93% | 53.08% | -4.79% | 1.05% | 0.67% |
| <u>Cash Ratio</u> | | | | | | |
| all | 47.99% | 26.28% | 27.50% | 1.05% | -0.41% | -0.75% |
| SOE Acquirer | 50.82% | 30.63% | 39.83% | -0.01% | -0.04% | 0.40% |
| POE Acquirer | 47.07% | 25.44% | 22.70% | 1.40% | -0.59% | -1.04% |
| <u>Capital Expenditure Rate</u> | | | | | | |
| all | 2.53% | 3.42% | 3.30% | -0.11% | 0.37% | 0.11% |
| SOE Acquirer | 3.10% | 4.68% | 4.42% | -0.20% | 0.71% | 0.42% |
| POE Acquirer | 2.31% | 3.21% | 3.10% | -0.07% | 0.21% | 0.00% |

Appendix, Classification of “Hot Political Period” in Chinese Market

We classify hot/cold political periods based on issuance of merger related acts/regulation, and National People’s Congress in China. <<< NOT SO CLEAR TO THE READER. BE MORE DESCRIPTIVE/EXPLAIN First, we identify key political dates of merger-related acts:

1. Sep 9th, 1999, Notification about Three Types of Companies (Bankrupt Enterprise, Policy-based bankrupt Enterprise, and Delisted Enterprise) Going Public, CSRC Notification.
2. June 14th, 2001, Act of State’s Stake Reduction in Listed Companies, CSRC Notification;
3. Sep 28th, 2002, Act of Merger and Acquisitions of Listed Companies, the 10th CSRC Order;
4. May 20th, 2003, Notification about listed company shares involved in tender offers, the 16th [2003] CSRC Company-sector Order;
5. Jan 6th, 2004, Notification about Standard Activities of Transferring Actual Control of Listed Companies, the 1st [2004] CSRC Accounting-Sector Order;
6. Sep 1st, 2006, Amendment of Act of Merger and Acquisitions of Listed companies, the 56th CSRC order;
7. Dec 10th, 2007, Working Regulation of Listed Company Merger and Acquisitions Audit Commission, CSRC Notification;
8. April 22nd, 2008, Act of Major Asset Reorganization of Listed Companies, the 53rd CSRC Order;
9. May 20th, 2008, new Listed Company Merger and Acquisitions Audit Commission established, CSRC Notification;
10. July 4th, 2008, Act of Financial Consultant of Merger and Acquisitions of Listed Company, the 54th CSRC order;

Meanwhile, National People’s Congress is held on March every year, which is also classified as hot political issues in this study. Second, hot political periods cover from one month before to one month after political issues. At all, there are 35 months classified as hot political months, among all 172 months.

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