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THE CHARACTERISTICS OF BIDDER COMPANIES IN INDONESIA AND THEIR RELATION TO THE SHAREHOLDERS' REACTION

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ABSTRACT

This study examines the characteristics of acquiring companies and their relation to the shareholders' reaction. The sample used in this study consists of 92 companies (46 bidders and 46 non-bidders). With respect to financial characteristics, this study finds that bidders have larger price to book value ratios than non-bidders. Further analysis also finds that cash to total assets ratio, profit before tax to total assets and operating income to total assets ratio are major factors in categorizing the companies into bidders and non-bidders group. Using linear regression, the result indicates that financial and corporate governance characteristics are able to affect shareholders' reaction around M&A announcement.

Keywords: merger and acquisition, corporate governance, shareholder's reaction, abnormal return, event study

JEL Classification: G14, G34, O16

INTRODUCTION

This study attempts to see whether financial characteristics of bidder companies are differ from those of non-bidder companies. Studies by Paliwal (2008) and Dutta (2011) among others, examine the characteristics of these two different groups of companies and they find that bidder companies have superior characteristics compared to non-bidder companies. On the contrary, Kurth and Lehnert (2006), in similar study, find that bidder companies has poorer characteristic than non-bidder companies. The inconsistency of these findings has open an opportunity to test the financial characteristics of bidder and non-bidder companies listed in Indonesia Stock Exchange (IDX).

This study also examines corporate governance characteristics of acquirers and non-acquirers. A company's management plays an important role in determining the appropriate strategy they should take. Corporate governance mechanism control the management's behavior to assure that their decisions is in line with shareholder interest. Studies by Kurth and Lehnert (2006) and Jong *et al.,*(2007) shows that the acquirers have weaker corporate governance mechanism than non-acquirers. On the other hand, a study by Paliwal (2008) finds that the acquirers have better corporate governance than non-acquirers. This inconsistency leaves a gap for further examination. The inclusion of corporate governance characteristics would expand our understanding that corporate governance can influence CEO decision to merge or acquire other company.

The decisions to takeover another company may affect acquirer's stock price. Shareholders reaction may be depicted in the acquirers' stock price volatility around merger and acquisition (M&A) announcement. The volatility of stock price will be used in this study to examine the reaction of shareholders by investigate the abnormal return on acquirers. In this study, the effect of financial characteristics and corporate governance characteristics on shareholder's reaction around the

announcement of M&A will also be examined.

MATERIALS AND METHODS

Kurt and Lehnert (2006) argue three major motive behind M&A activities i.e., synergy motive, agency, and hubris motive. The synergy will not achieve when only an acquirer or a target have positive impact of M&A activity. Thus, if M&A are motivated by synergy, both of acquirer and target will be positively correlated with each other. Manager with agency motive have a large chance to use company's resources to make a deal on M&A activity. Sharma and Ho (2002) argue that when M&A are based on agency motive, these activity are motivated by the self-interest of the acquirer's management rather than maximizing shareholder wealth. Study by Soegiharto (2010) partially focus on CEO in company who have an important role in M&A decision-making process. He stated that the performances of acquirer would be damage if paying premium to much to target. It occurs because CEOs' overconfidence behavior may overestimate the values of target. Financial characteristics as a result from financial ratios (Sorensen 2000). Financial ratios enable the manager to forecast trends in a business and to compare its performance with the average performance of similar businesses in the same industry. This study uses 5 groups of financial ratios (liquidity, profitability, leverage, activity, and marketratios) as an instrument to compare between the acquirer companies and non-acquirer companies.

Based on the three motivation as this study mentioned above, management in acquiring company sometimes do not always act in the interest of the shareholders and therefore at least some M&A are based on selfish motives of the management. To keep these at a minimum level, a comprehensive set of corporate governance measures have to be assessed. Dutta (2011) also suggest that the high level of managerial ownership indicate the company may be less likely to make M&A decision. Considering this view, the acquirers are expected have lower level of managerial ownership than non-acquirers.

Winarno (2012) argues that the public ownership may influence manager's behavior in decision making process. Public ownership defined as the proportion of individuals who have a number of shares in the company. This individual comes from outside company. This study argues that the presence of large public ownership would make management more careful in making M&A decision. The failure of management in making decision may affect to the company's image in public. Therefore, it is expected that the acquirers have less public ownership than non-acquirers.

This study assumes that the Board of Commissioner especially Independent Commissioners have similar role with non-executive directors. The Independent Commissioners should ensure that the control mechanism runs effectively and ensure that the Board of Directors activities in line with shareholder's interest. Thus, the acquirers should have less proportion of Independent Commissioner than that of non-acquirers. A study by Kurth and Lehnert (2006) try to investigate whether the impact of prior company's performance, prior resource availability, and the characteristics of corporate governance have a tendency in M&A activity. The results in their study suggest that corporate governance have an important role to oversee the management to act in the interests of shareholders. If corporate governance runs effectively, the possibility of manager to performM&A will decrease.

Sorensen (2000) who distinguish companies into acquirer, target, and non-acquirer also finds a similar result. He finds that profitability is the only significant measure and acquirers are more profitable than both targets and non-acquirers. The performance of acquirers prior to M&A should be better than that of non-acquirers. The M&A activity may used by management as an alternative to expand their business. Thus, the first hypothesis is formulated as follow:

H1a: The financial characteristics of acquiring companies prior to M&A announcement are better than that of non-acquiring companies.

When past performance is used as references for the management to merge or acquire other company, there would be a reaction from shareholders regarding the M&A decision because shareholders are the owners of the company in the form of stock ownership. An empirical evidence by Paliwal (2008) and Baker *et al.,*(2012) also find that abnormal return are negative for acquirers around M&A announcement. They argue that the negative reaction arises because M&A are driven by hubris or agency motive. Thus, this study argues that the prior performances of bidders have an

affect to the shareholders' reaction. Therefore, this hypothesis is proposed as follows:

H1b: The financial characteristics of acquirers prior to M&A have an affect to the shareholders' reaction around the date of announcement.

Gompers et al., (2003) and Kurth and Lehnert (2006) investigate the effect of corporate governance characteristics on acquiring companies in M&A. Using the Governance Index to proxy the level of shareholders' role, they find that the companies which limit their shareholder's role are more likely to become active in M&A. Furthermore, study by Paliwal (2008) finds that the acquirers are characterized by their low insider ownership and high institutional ownership.

Dutta (2011) also finds that acquirers have lower insider directors ratio, higher board size, and lower institutional ownership than non-acquirers. Based on the studies discussed above, it can be deduced that the quality of corporate governance has an important role in determining whether the companies become an acquirers. The acquirers should have good quality in corporate governance as a reference to manage the target. Hence, the second hypothesis is formulated as follow:

H2a: The corporate governance characteristics of acquiring companies prior to M&A announcement are better than that of non-acquiring companies.

A study by Jong et al., (2007) examines the effect of corporate governance on shareholders' reaction around M&A. They find that the corporate governance characteristics positively affect the shareholders' reaction on acquiring company. The better quality on corporate governance indicates that the board's monitoring system working properly in internal monitoring and external monitoring. This condition is tend to make a company have capability in M&A activity. Thus, the hypothesis is:

H2b: The corporate governance characteristics of acquirers prior to M&A have an affect to the shareholders' reaction around the date of announcement.

This study selects all Indonesian M&A deals that occurred between 2003 and 2011. Both acquirers and non-acquirers are members of Indonesia Stock Exchange (IDX). The sample in this study is required to meet the following criteria: (1) the acquirers are publicly traded and from all industries, (2) the acquirers undertook only one M&A during the examination period. Both accounting information and corporate governance data of acquirers and non-acquirers are collected from Indonesian Capital Market Directory (ICMD). For non-acquirer groups, this study select the firms that are not make any acquisitions between 2003 and 2011. They also have to have similar total assets or net sales compared to each acquiring firms. Thus, each of the acquiring and non-acquiring firms is matched paired. In addition, the acquirers' historical stock prices are collected from Indonesia Stock Exchange.

First, paired-sample *t test* is used to test the hypotheses 1a and 2a. Hypothesis 1a and 2a examine whether the financial and corporate governance characteristics of bidders are better than that of non-bidders

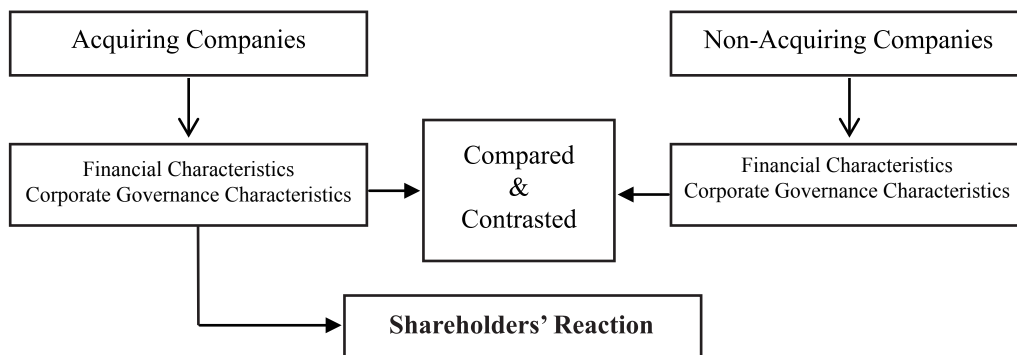

Figure 1
Research Framework

prior M&A announcement. Therefore, the compare mean analysis is performed. For further analysis, this study also use logistic regression to predict which financial characteristics and corporate governance characteristics are able to categorize companies into acquirers or non-acquirers. The factor analysis is performs before run the logistic regression. In the logistic regression, financial ratios and corporate governance characteristics are independent variables. Dependent variable is a dummy variable. The value is '1' if the company in the sample makes a merger or acquisition during the period 2003 to 2011 and '0' otherwise. The logistic regression model:

$$P(Y) = \frac{1}{1+e^{-(\beta_0+\beta_1 x_1+\beta_2 x_2+\ldots+\beta_n x_n)}}$$

where *P(Y)* is the probability of company being a bidder or non-bidder. β is the set of regression coefficient for the X_n characteristics. X_n is a measurable financial characteristics and corporate governance characteristics.

Next, linear regression is performs to test the hypothesis 1b and hypothesis 2b. The CAR observed around announcement date as the dependent variable. Financial characteristics and corporate governance characteristics are the independent variables in this study. For event study methodology, the first step to do is compute actual return on estimation period. The next step is calculate normal return using mean adjusted return model described by Brown and Warner (1985). The estimation period runs from day -220 to day -20 prior M&A announcement.To capture the total effect of stock movements for entire event period in which the market may respond to the new information, the cumulative abnormal return (CAR) is calculated by summing all abnormal return on event period.

Table 1
Descriptive Statistics

Ratio	Variables	Mean		Standard Deviation	
		Bidder (N= 46)	Non-Bidder (N= 46)	Bidder (N= 46)	Non-Bidder (N= 46)
Liquidity	(CashEq-CL)/TA	-0.32726	-0.38223	0.26949	0.50554
	CashEq/CL	0.42592	0.68952	0.73639	1.71044
	CA/CL	3.41348	1.93762	7.77016	1.89178
	Cash/TA	0.07248	0.09345	0.08415	0.13250
Profitability	PBT/TA	0.02653	0.04087	0.22998	0.11464
	PBT/NS	-0.72162	-0.19593	4.30274	2.03332
	NI/NS	-1.16177	-0.28826	5.79401	3.32425
	NI/TA	-0.03826	0.04371	0.54908	0.11938
	NI/SE	2.20824	0.05211	14.28413	0.87016
	GP/NS	0.41517	0.40619	0.33617	0.35029
	OI/NS	-0.27175	-0.21740	1.91430	2.03923
	OE/NS	0.77748	0.63551	1.96887	2.14000
	OI/TA	0.04256	0.05115	0.19337	0.07389
Leverage	NCL/TA	0.28906	0.21808	0.34109	0.29592
	TL/TA	0.67948	0.65352	0.40224	0.46280
	LTL/SE	1.35381	2.51005	3.13583	11.61743
Activity	NS/(CA-Inv)	2.55316	4.18685	2.72505	10.58526
	NS/TA	0.54674	0.92827	0.48943	1.59437
	CA/NS	3.75090	9.68856	6.62089	46.11539
	Cash/NS	0.30780	0.36906	0.48876	0.84281
	OCF/NS	-0.17188	0.05073	0.93624	0.55745

Market	EPS	103.08980	95.53425	209.73744	173.26537
	PBV	7.52312	2.66072	19.62859	7.92679
	PER	17.85457	20.47957	45.77802	36.64554
	DivPay	9.67569	8.23464	22.64845	18.66458
Corporate Governance	ManOwn	0.04949	0.02069	0.14708	0.05546
	InstOwn	0.68139	0.69109	0.19394	0.18219
	PublOwn	0.27321	0.27581	0.18423	0.17624
	IC/TB	0.13407	0.17860	0.09582	0.06403
	NumIC	1.08696	1.62319	0.85037	0.85088
	Valid N (listwise)				

Source: Empirical result.

Table 1 presents the financial and the corporate governance characteristics on each measurement. The table shows that the liquidity ratios of bidders are better than non-bidders in the mean of CA/CL variable. The mean profitability and market ratios also show that bidders' performances are better than non-bidders prior to the announcement of M&A. Nevertheless, the averages of leverage and activity ratios of bidders are less than their peer. In term of corporate governance, bidders have higher mean on managerial ownership than non-bidder.

This study examines whether the bidders premerger performance are better than that of non-bidders. The performances of bidders and non-bidders are measured during the same period. This study also examines the difference of corporate governance characteristics between bidders and their peers (non-bidders). Paired-Sample *TTest* is used because bidders and non-bidders are tested in pair. The results of the test are presented in Table 2.

Table 2
Paired-Sample T Test

Paired Variable	N	Mean		df	t	Sig. (2-tailed)
		Bidder	Non Bidder			
PBV	46	7.52312	2.66072	45	-1.705	0.095*
IC/TB	46	0.13407	0.17860	45	2.488	0.017**
NumIC	46	1.08696	1.62319	45	3.702	0.001***

Note: *, **, and *** indicate statistical significance at 10%, 5%, and 1% levels, respectively
This table only shows the variables which are statistically significance

Source: Empirical result.

From the univariate analysis presented in Table 2, this study found that PBV (price to book value), IC/TB (independent commissioner/total board size), and NumIC (total number of independent commissioner) of bidders and non-bidders are significantly different. The mean of PBV (at significance level of 10%) shows that bidders have higher price to book value ratio than non-bidders. Price to book value can be used to indicate the condition of company's performance. Thus, it can be deduced that the acquirers have better performance than non-acquirers. Furthermore, it can be inferred, using PBV ratio, the bidders are more potentially to grow than non-bidders (Dutta 2011). In this study, the only ratio which support hypothesis 1a is PBV.

For corporate governance characteristics, the result indicates that bidders are less monitored by the independent commissioner than non-bidders. Table 2 shows that bidders have 13.4% of IC/TB which

is lower than that of non-bidder which is 17.86%, on average. NumIc variable also shows that bidders have less member of independent commissioner compared to that of non-bidders.Indonesia's Code of Good Corporate Governance states that the function of independent commissioners is to ensure that the control mechanism runs effectively and in accordance with laws and regulations. Thus, based on the results presented in table 2, hypothesis 2a (the bidders have better corporate governance characteristics than that of non-bidders) is rejected.

For further analysis, logistic regression is performed to examine whether financial characteristics and corporate governance characteristics are able to separate companies into two categories, bidder and non-bidder. In order to test hypotheses 2a and 2b, linear regression tests are taken using cumulative abnormal return as a dependent variable and financial and corporate governance characteristics as independent variables.The factor analysis technique is considered to be taken because of the use of various ratios in different measurement. The factor analysis result is not presented in this study.Table 3 presents the result of logistic regression model, as follows:

Table 3
Contribution of Variable

Overall Predictive Value: 66.3% Ratio	Variable	Beta	Wald	Sig.
Liquidity	CashEqCLTA	4.510	2.063	0.151
	CashTA	-7.750	3.494	0.062*
Profitability	PBTTA	14.465	3.298	0.069*
	NITA	-7.533	1.348	0.246
	OITA	-10.574	2.836	0.092*
Leverage	NCLTA	-3.039	1.126	0.289
	TLTA	2.553	0.751	0.386
Activity	CashNS	-0.193	1.173	0.279
	OCFNS	0.141	1.514	0.218
Market	EPS	0.001	0.209	0.647
	PBV	0.035	2.631	0.105
	DivPayout	0.005	0.265	0.606
Corporate Governance	InsOwn	-1.813	0.764	0.382
	PublOwn	-0.339	0.027	0.870
Constant		2.462	1.514	0.219

Note: *, **, and *** indicate statistical significance at 10%, 5%, and 1% levels, respectively.

Source: Empirical result.

The overall predictive value in Table 3 shows that the model correctly classified 66.3 per cent of cases. It means that the logistic regression model employed in this study can classify the companies (66.3%) into two different groups, bidder and non-bidder. Table 3 shows that three significant variables i.e. Cash/TA, PBT/TA, and OI/TA are major factors in predicting the likelihood of company's manager to merge or acquire other company. Liquidity ratio, measured by Cash/TA, has a negative sign implying that the better the level of company's liquidity, the less likely the company become acquirer.

The variable PBT/TA shows a positive value (14.465). This indicates that an increase of company's profitability as measured with PBT/TA ratio will result in an increase probability of company to acquire or merge with other company. A profitable company might consider M&A as a chance to expand its business because they may believe that they would be able to produce better performance by taking over

other companies. In contrast, profitability ratios as measured by OI/TA have negative sign. It implies that the company with a less OI/TA ratio is more likely to become an acquirer. The company with less operating income would be attempting to boost their performance by increasing sales or decreasing operating costs. For example, a company may acquire their supplier in order to decrease the cost of raw materials. There is weak evidence that corporate governance quality has an effect on M&A decision. In this study, none of corporate governance ratios are statistically significant.

In the earlier section, this study predicts that the past financial and corporate governance characteristics of acquirers affect the shareholders' reaction around the date of M&A announcement. The cumulative abnormal returns for the 46 acquisitions are regressed against the financial and corporate governance ratios using linear regression technique.Linear regression is used to test the hypothesis 1b and 2b and the results of the test are presented in Table 4. Following a study by Trahan (1993), the dependent variable in the regression is the CARs of the bidder in the window t-2 to t+2. Table 4 below shows the ratios that may influence shareholders' reaction around an M&A announcement.

Table 4
Regression Analysis of Bidders' CAR

Dependent Variable:	Model 1		Model 2		Model 3	
CAR (-2,+2)	Beta	Sig.	Beta	Sig.	Beta	Sig.
Constant	-0.113	0.026**	0.161	0.104	-0.098	0.421
(CashEq-CL)/TA	0.701	0.043**			0.616	0.053*
Cash/TA	-0.608	0.125			-0.627	0.085*
PBT/TA	-0.699	0.071*			-0.778	0.040**
NI/TA	0.0032	0.774			0.031	0.767
OI/TA	1.019	0.061*			1.128	0.032**
NCL/TA	-0.669	0.049**			-0.651	0.037**
TL/TA	0.781	0.023**			0.762	0.016**
Cash/NS	0.054	0.146			0.083	0.039**
OCF/NS	-0.030	0.113			-0.045	0.030**
EPS	0.000	0.687			0.000	0.402
PBV	0.001	0.115			0.001	0.228
DivPayout	0.000	0.331			0.000	0.242
InsOwn			-0.131	0.223	0.035	0.771
PublOwn			-0.260	0.024**	-0.234	0.033**
No. of observation		46		46		46
P-value for F-test		0.228		0.065*		0.050**
R^2		0.333		0.119		0.478
SE of the Estimate		0.096487		0.097099		0.088055

Note: *, **, and *** indicate statistical significance at 10%, 5%, and 1% levels, respectively

Table 4 provides a linear regression with three different models. Model 1 uses only financial ratios as independent variables, Model 2 shows the corporate governance ratios as independent variables, and Model 3 uses both financial and corporate governance ratios as independent variables. The result shows that the R^2 and SE_E of Model 3 are 0.478 and 0.088055, respectively, which are better than Model 1 and 2 in predicting accuracy. The *P*-value of 0.050 in Model 3 is also statistically significant. The stronger effect on the shareholders' reaction in Model 3 (compared to Model 1 and 2) may be due to the inclusion of not only financial condition but also corporate governance ratios. Nevertheless, hypothesis 1b and 2b are accepted

based on the three model of regression.

Column labeled "Beta and Sig." on Table 4 presents the contribution of each independent variable to predict dependent variables. In Model 1 which is used to test the hypothesis 1b, the (CashEq-CL)/TA, PBT/TA, OI/TA, NCL/TA, and TL/TA ratios are all significant at the 0.05 and 0.1 level. The signs of (CashEq-CL)/TA coefficient in Model 1 and Model 3 are positive which indicate that firms with high level of liquidity ratio (measured by (CashEq-CL)/TA) experience higher positive cumulative abnormal return which drive the increase of shareholders' wealth. In contrast, liquidity ratio (measured by Cash/TA) in Model 3 is statistically significant and has negative sign. This differs from the Cash/TA variable in Model 1 which is statistically insignificant.

The signs of PBT/TA coefficient in Model 1 and Model 3 are negatively significant in explaining CAR around M&A announcement. It implies that company with a high level of profit tends to have lower cumulative abnormal return. Since they already have high profit, the shareholders may not consider M&A as an alternative to expand their businesses. Operating income to total assets (OI/TA) shows positive sign and is statistically significant in Model 1 and Model 3. This sign suggests that the companies with high level of OI/TA may have positive CAR around M&A announcement. The positive CAR may indicate the likelihood of shareholders' wealth enhancement.

Model 1 and Model 3 shows negative sign for non-current liabilities to total assets (NCL/TA). It suggests that the companies with high level of NCL/TA may cause the shareholders to react negatively. The high level of NCL/TA indicates that the company has poor performance and thus the CAR of acquirers will be negative around M&A announcement. In contrast, the leverage ratios measured by TL/TA shows positive sign. It implies that the higher the level of TL/TA (poor performance), the more likely the positive CAR will be. The shareholders of acquiring companies may consider that M&A deal as a way to decrease their leverage ratio. Model 3 shows the Cash/NS and OCF/NS variables are statistically significant with positive and negative sign. On the other hand, none of these ratios are significant in Model 1. The positive sign in Cash/NS indicates that the company with high Cash/NS prior to M&A announcement experience higher shareholders' wealth because the CAR is positive. Operating cash flow to total assets shows negative sign. It indicates that the company with high OCF may cause the shareholders of acquiring company to react negatively around M&A announcement. The higher of OCF/TA indicates that the company's performance is poor.

For corporate governance characteristics, public ownership is the only variable which is statistically significant with negative sign in Model 2 and Model 3. It implies that the company with large proportion of public ownership may produce negative CAR which, in turn, decreasing the shareholders' wealth.

RESULT AND DISCUSSION

Based on research question and research objectives presented in earlier section, this study examines whether financial characteristics and corporate governance characteristics of acquiring companies are better than those of non-acquiring companies. Based on univariate analysis, PBV ratio is the only financial characteristic which is statistical significance. The mean of PBV (significance level at 10%) shows that bidder have higher price to book value ratio than non-bidder. In addition, the bidders have less independent commissioner compared to the non-bidders in their board of commissioner structures. It suggests that bidders' management are less monitored by independent commissioner. A further analysis using logistic regression finds that Cash to Total Assets ratio, Profit before Tax to Total Assets, and Operating Income to Total Assets ratio are variables that significantly predict companies as bidders or non-bidders.

This study also examines whether the financial characteristics and corporate governance characteristics of acquirers affect the shareholders' reaction around M&A announcement. Overall, the combination of financial condition and corporate governance quality prior to M&A presents a good fit in affect the shareholders' reaction around M&A announcement.

CONCLUSION AND SUGGESTION

Conclusion

Financial characteristics and corporate governance characteristics are able to separate companies into bid-

ders group or non-bidders group. Empirical results suggest that bidders' performance are better than the non-bidders' performance which is measured by price to book value. For corporate governance quality, bidders are less monitored by independent commissioner. This finding indicates that corporate governance mechanism (independent commissioner)control the management's behaviorin order to monitor the managers' decision. The two characteristics (financial and corporate governance) also able to affect the shareholders' reaction around M&A announcement.

Suggestion

This study do not examine the characteristics of target companies as a comparison to the acquirers because the lack of data availability. The targets are private companies because they do not publicly traded in IDX. There is no distinction is made between M&A and the two notions are treated as one. The sample would be drop if merger and acquisition activity examined separately. Thus, the future research should be able to cover these limitations. The characteristics of target should be examined in order to find a comprehensive understanding in M&A literature especially in Indonesian research. The separate examination in M&A would be better if the sufficient data concerning M&A are available.

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