



# Abnormal returns of Japanese acquisition bidders—impact of pro-M&A legislation in the 1990s

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Received 5 March 2003; accepted 6 October 2005

Available online 6 January 2006

## Abstract

This paper examines the market's reaction to news of corporate mergers and acquisitions (M&A) by Japanese bidders during the 1990s. Domestic versus global bids and pro-M&A legislation are considered as determinants of bidders' abnormal returns. The results show that bidders for domestic targets earn significant abnormal returns after the institutions of pro-M&A legislation in Japan. These findings help determine gains from trading strategies for M&A deals in Japan, and provide insight into the current M&A environment in Japan as shaped by pro-M&A legislation.

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*JEL classification:* G14; G18; G34; G38; M40

*Keywords:* Japan; Merger and acquisition; Abnormal returns; Big bang reform; Legislation; Corporate governance; Bank

## 1. Introduction

In response to the prolonged economic slowdown in the 1990s, the Japanese government has been making many legislative changes to boost the economy by attracting capital transfusion from overseas and by reallocating capital within the country. As a result, the mergers and acquisitions (M&A) market in Japan has become quite active. Prior research has documented significant positive gains to shareholders of acquiring firms (Pettway and Yamada, 1986); however, the economic context in prior research differs drastically from the 1990s and this difference likely impacts market response to M&A transactions.

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This paper examines the market's reaction to news of corporate acquisitions by 152 Japanese bidders<sup>2</sup> between 1/1/1990 and 12/31/2000. Specifically, this paper considers domestic versus global bids and pro-M&A legislation as determinants of bidders' abnormal returns surrounding the bid announcements. The distinction between bidders for domestic targets (hereafter, domestic bidders) versus bidders for global targets (hereafter, global bidders) is motivated by the Japanese M&A landscape in the 1990s, where global bids may be subject to a diversification discount due to heightened complexity in coordinating corporate policies in a cross-border environment (Denis et al., 2002). The distinction between before and after pro-M&A legislation also is motivated by the new M&A landscape in the country, where bidders' acquisition costs are alleviated by pro-M&A legislation.

Our findings demonstrate the importance of Japanese pro-M&A legislation as a determinant of investor reaction to announcements of bids. Specifically, after enactment of pro-M&A legislation, cumulative abnormal returns (CAR) accruing to domestic bidders over the 40 trading days surrounding a bid announcement are significantly positive, while CAR to global bidders are significantly negative. Bidder size, growth, leverage and governance are included as control variables, but the associations between these variables and bidder CAR are typically insignificant both before and after pro-M&A legislation enactment. Our results are in contrast with Kang et al. (2000), who found that main bank relationship explains most of the positive significant gains to Japanese bidders; however, our results are consistent with the notion that troubled banks could not effectively monitor firms in the 1990s (Gibson, 1995; Kang and Stulz, 2000; Kang et al., 2000).

Prior work by Pettway and Yamada (1986) examined bidder returns in Japanese mergers during 1977–1984; Kang (1993) examined Japanese acquisitions of U.S. firms from 1975 to 1988; Kang et al. (2000), Yeh and Hoshino (2001) and Inoue (2002) examined returns to domestic mergers in Japan during 1977–1993, 1981–1998 and 1990–2000, respectively; Yeh and Hoshino (2002) and Kruse et al. (2002) examined the operating performance of mergers from 1969 to 1992 and 1970 to 1994, respectively. In sum, prior studies have not distinguished between domestic versus global acquisitions and, except for Inoue (2002), prior studies have not used data after major M&A legislation. Inoue (2002) examined the returns to acquirers and targets, but did not analyze the determinants of CAR.

This paper contributes to the literature in three ways. First, its examination period is the 1990s, a crucially different economic period from those examined in prior literature due to the unprecedented economic slowdown in Japan. Investors' reactions to corporate events during the economic slowdown are likely to differ from those in the preceding economic boom. Second, this paper focuses on the impact of pro-M&A legislation in Japan, which was not done in prior literature. Pro-M&A legislation purports to help reallocate capital more efficiently; however, its impact on merger bidders was not known. Third, this paper distinguishes between domestic versus global bids, a distinction not made in prior literature, but pertinent to the Japanese M&A landscape. Overall, this paper's findings highlight the impact of pro-M&A legislation in the 1990s and the findings are sharpened when one distinguishes between domestic versus global bids.

This paper proceeds as follows. Section 2 reviews the literature relevant to M&A activity in Japan. Section 3 discusses possible determinants of bidder abnormal returns. Section 4 describes the methodology. Section 5 discusses the empirical results and robustness checks. Section 6 concludes.

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<sup>2</sup> The sample sizes in Japanese M and A studies are typically small. For example, Kang (2000) obtained a sample of 154 bidders for the period between 3/31/1977 and 12/31/1993. The number of targets is substantially lower, as many targets are privately held and therefore do not have publicly available data.

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