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The M&A Short-Term Wealth Effect of A Consistent Dividend-Paying Firm

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Abstract

The paper examines the M&A short-term wealth effect of a consistent dividend-paying firm. The consistent dividend-paying firm is unique because they are associated with lower agency problems. Hence, it is expected that the M&A by the dividend-paying firm has a short-term positive wealth effect. To test the hypothesis, we perform two steps analysis. The event-study method examines the acquirer stock performance on the announcement date, the deal close date, and the announcement to deal close date. The cross-section regression to test the short-term wealth effect of M&A by the dividend-paying firm. The dependent variable is the acquirer's stock performance from the event-study method. The independent variable is a dividend-paying firm. The control variables are the acquisition deal value relative to the acquirer's stock market capitalization, the acquirer's stock dividend yield, and the acquirer's price-to-book value (PBV) ratio. The samples are M&A transactions in ASEAN-5 (Indonesia, Malaysia, The Philippines, Thailand, and Vietnam) for 2015-2019. The regression analysis shows that the variable representing a dividend-paying firm has a negative sign. The finding suggests that investors react negatively to the M&A by the dividend-paying firm. The negative wealth effect is relatively small compared to the M&A deal value and the acquirer's stock valuation. The result is that the M&A by a dividend-paying firm provides a short-term positive wealth effect.

Keywords: ARDL model; asymmetric effect; bank lending; bank performance; bank soundness

JEL Classification: G34, G35

1. INTRODUCTION

Merger and acquisition (M&A) enable a firm to acquire a new competitive advantage in a relatively short-term period (Hossain, 2021; Maksimovic, Phillips, & Prabhala, 2011). M&A opens firm access to the international market (Lee, 2017; Sahu & Agarwal, 2017), gains more customer information (Degbey & Pelto, 2021), and access to new technology (Lee, 2017).

Current research findings on the acquirer wealth effect for an M&A transaction remains have considerable variations. Rao and Mishra (2020) find a significant variation in the M&A wealth effect contingent on the market competitiveness. Fuller, Netter, and

Stegemoller (2002) find that M&A wealth effects are contingent on the target company's status, i.e., public or private. M&A for public firms have a negative wealth effect, and for private firms have a positive wealth effect. Kiesel, Kolaric, and Schiereck (2016) find that M&A in the logistic industry results in a short-term positive wealth effect. The M&A positive wealth effect is associated with post-M&A higher Return on Assets. Glambosky, Rakesh, and Ngoc (2020) find that M&A by a dividend-paying firm have lower negative short-term wealth effects than non-dividend-paying firms. Turki and Dereeper (2012) find that the M&A wealth effects are influenced by the M&A payment methods, i.e. cash or stock. They find that a stock payment results in a negative wealth effect. Alexandridis, Petmezas, and Travlos (2010) find that acquirer shareholders experience adverse wealth effects for M&A transactions in a highly competitive takeover market.

One established research strand to explain the failures of an M&A transaction is agency theory. The agency theory suggests that the firm manager acts more for their benefit than shareholders' benefit. Firms with a more serious agency problem are expropriating a larger portion of free cash flow (Berzins, Bøhren, & Stacescu, 2019; Xu & Huang, 2021). One primary strategy to expropriate free cash flow is through M&A. The M&A increases management compensation and information asymmetry through more complex business operations. The higher compensation and information will only benefit the agent of the cost of shareholders (Gantchev, Sevilir, & Shivdasani, 2020).

The agency costs hinge on the availability of firm free cashflows. Management may choose to signal that they are trustworthy by reducing the source of the agency costs through consistent and higher dividend payments. Sun and Yu (2022) find that as the Board of Director activity increases, firm tend to have higher dividend payments. Higher dividend payments will reduce the firm cash availability. Research on the wealth effect of M&A transactions focuses only on a dividend-paying firm. Glambosky et al. (2020) and Turki and Dereeper (2012) do not mention firm that consistently pays dividends. Based on this consideration, the research problem is a research gap on the M&A wealth effect of a consistent dividend-paying firm.

The research objective is to add new empirical evidence on the short-term wealth effect of a consistent dividend-paying firm M&A in the Asia Pacific market. Based on the research objective, we provide three research novelty. First, testing the short-term market reaction to M&A transactions from a firm that consistently pays dividends. Second, providing empirical evidence from an M&A transaction performed by the dividend-paying firm in the ASEAN-5 countries. The research need is consistent with Faff, Prasadh, and Shams (2019) suggestion to examine theories and empirical evidence in the Asia Pacific market. Third, the study uses a recent period, i.e. 2015-2019, while Glambosky et al. (2020) use the old period, i.e. 1995-2014. We do not include 2020-2021, considering the covid-19 pandemic needs a different theory for the crisis period.

The research question is, "What is a consistent dividend-paying firm's M&A short-term wealth effect? There are three significant research findings. First, the short-term wealth effect is only positive on the announcement date. Second, the shareholders of a consistent dividend-paying firm react negatively to M&A announcements. Third, the short term negative wealth effect is relatively small compared to the positive wealth effect from a higher M&A deal value relative to the acquirer's stock market capitalization and higher valuation.

2. HYPOTHESES DEVELOPMENT

The firm's life cycle theory suggests five life cycle stages: introduction, growth, maturity, shake-out, and decline (Dickinson, 2011; Dickinson, Kassa, & Schaberl, 2018). As firms progress from the introduction to the growth stage, firm invest heavily to capture market potential and increase their competitive advantages. Within the period of growth, firm investments result in negative cash flow. When a firm reaches the mature stage, the firm has a stable position in the market, and firm growth equal to industry growth. Hence firm investment requirements will be lower. Mature stage firms start accumulating free cash flow.

Bhattacharya, Chang, and Li (2020) suggest that the five stages of a firm life cycle are non-linear. The firm may change its life cycle from mature to growth or vice versa, shake-out to growth or vice versa, and decline to growth or vice versa. The transition initiatives may come from shareholders who are not satisfied with the current investment return. The larger the number of dissatisfied shareholders will force the firm to seek new growth opportunities.

New growth opportunities may arise from M&A transactions within and across the firm's industry. Teti and Tului (2020) analyze within-industry M&A transactions, specifically in the utilities and infrastructure industry. They find acquirer earn a positive abnormal return even though not statistically significant at alpha 10%. Renneboog and Vansteenkiste (2019) also find that M&A in the related industry have higher performance than in unrelated industries. Wei, Qiao, and Lv (2020) suggest that M&A in the petroleum industry enables the acquirer to learn new technology from acquired competitors.

The agency theory discusses the relations between principal and agent. The relations are built under the assumption that both principal and agent want to maximize their utilities, and the agent has an information advantage relative to the principal (Jensen & Meckling, 1976). The source of agency costs is the existence of free cash flow. Managers can use the free cash flow to pursue personal benefits, i.e., pet projects (Fairchild, 2010) and empire building (Hope & Thomas, 2008). The agency problems can be reduced when the agent distributes free cash flow to shareholders through cash dividends (DeAngelo, DeAngelo, & Stulz, 2004) and share repurchase (Grullon & Michaely, 2002).

Firms reduce the source of agency problems by reducing the free cash flow, i.e. consistently paying out dividends. A consistent dividend-paying firm suggests that management motivation is aligned with the shareholders. Shareholders will positively perceive that the M&A is not motivated to create an empire (Glambosky et al., 2020). The M&A change the firm lifecycle stages back to growth stages or prolong the growth stages. The growth stages are related to higher sales growth and profitability. Hence, the shareholders will react favourably to M&A by a consistent dividend-paying firm. The hypothesis offered is:

H.1. M&A by a dividend-paying firm provides a short-term positive wealth effect.

The short-term wealth effect can be divided into announcement date, closed date, and the period between announcement to close date. The hypothesis offered are:

H1a M&A by dividend-paying firm announcement provides a positive short-term wealth effect.

H1b M&A by dividend-paying firm closed dates provides a positive short-term wealth effect.

H1c M&A by the dividend-paying firm period between announcement and closed dates provides a positive short-term wealth effect.

Shareholder scrutiny of the M&A hinges on the potential benefit, i.e. proxied by M&A deal value. The larger the deal value, the larger the potential M&A benefits. Norli, Ostergaard, and Schindele (2015) find that shareholders' scrutiny is a sinking cost and costly. After the costs are incurred, the results may be supportive or unsupportive for M&A approval. Hence, the deal value should be large enough to increase the firm's future competitiveness and stock valuation to induce the shareholders' scrutiny. The hypothesis offered is:

H2 M&A deal value provides a short-term positive wealth effect.

DeAngelo et al. (2004) find that firms with a higher dividend payout ratio tend to have a lower retained earnings ratio relative to total equity. A high dividend payout ratio implies lower agency problems. The hypothesis offered is:

H3 High acquirer's stock dividend yield has a short-term positive wealth effect.

Renneboog and Vansteenkiste (2019) suggest that Mergers and Acquisitions (M&A) are preferred methods to transition from the mature to the growth stage. The higher stock valuation also suggests that the management can maintain the firm competitive advantage (Ting, Tebourbi, Lu, & Kweh, 2021). Hence higher acquirer's stock valuation may increase the likelihood of a successful transition to the growth stage. The hypothesis offered is:

H4 High acquirer's stock valuation has a short-term positive wealth effect.

3. DATA AND RESEARCH METHODS

Data

We obtain M&A transactions from S&P Capital IQ. The criteria and the results are presented in table 1 below. The countries under consideration are ASEAN-5 countries that consist of Indonesia, Malaysia, the Philippines, Thailand, and Vietnam. We exclude the year 2020-2021 into consideration other theories than agency theory will better explain the M&A wealth effect in the covid-19 pandemic. We exclude the financial and utility sector in consideration that their M&A motive is significantly different from the other sector. Teti and Tului (2020) argue that M&A in the utilities and infrastructure industry by institutional investors are motivated to gain stable income. Hence, the firm life cycle remains in the mature stage. Hannan and Pilloff (2004) suggest that M&A is one method for the bank to meet a higher capital requirement under Basel Capital Accord. The bank life cycle stages also remain in the mature stage.

We process the data further to understand the country's M&A transaction distribution. The result is presented in table 2.

Table 1. Results of Data Screening

Criteria	Announced	Closed	Announced-Closed
Total firms recorded: ASEAN-5 2015 to 2019 Domestic	760	933	1132
(-) Financial and utility sector	680	822	680

Criteria	Announced	Closed	Announced-Closed
Deal value > US\$1 million	465	650	473
Acquiring >10% ownership of target firm	311	463	257
Transaction status: closed deal	248	298	226
(-) Firm has not done IPO (stock price unavailable)	222	196	189
(-) Incomplete / unexplainable data	201	196	180
(-) Data does not meet criteria: The transaction period lies outside 2015 and 2019.	180	179	173
Total Research Sample	180	179	173

Source: S&P Capital IQ

Table 2. Country M&A Transaction

Year	Country	ANNOUNCED		CLOSED		ANNOUNCED-CLOSED	
		Dividend-Paying	Non Dividend-Paying	Dividend-Paying	Non Dividend-Paying	Dividend-Paying	Non Dividend-Paying
2015	Indonesia	3	2	4	2	3	2
	Malaysia	19	13	15	12	14	11
	Philippines	4	3	5	2	5	2
	Thailand	4	8	4	5	4	4
	Vietnam	1	4	1	4	1	4
2016	Indonesia	0	1	0	2	0	1
	Malaysia	11	11	11	7	11	6
	Philippines	7	1	7	1	7	1
	Thailand	6	5	4	7	4	7
	Vietnam	0	0	0	0	0	0
2017	Indonesia	2	1	0	2	0	2
	Malaysia	12	10	12	11	12	11
	Philippines	3	2	2	1	2	1
	Thailand	1	1	1	4	1	4
	Vietnam	0	1	0	2	0	1
2018	Indonesia	3	1	3	1	3	1
	Malaysia	3	3	8	7	8	7
	Philippines	1	3	2	3	2	3

Year	Country	ANNOUNCED		CLOSED		ANNOUNCED-CLOSED	
		Dividend-Paying	Non Dividend-Paying	Dividend-Paying	Non Dividend-Paying	Dividend-Paying	Non Dividend-Paying
2019	Thailand	2	6	3	3	3	4
	Vietnam	0	3	0	3	0	3
	Indonesia	0	1	0	1	0	1
	Malaysia	2	6	3	2	3	2
	Philippines	2	1	2	2	2	2
	Thailand	2	4	3	4	1	6
	Vietnam	1	0	1	0	1	0
	Sub-Total		89	91	91	88	87
Total Transactions		180		179		173	

Source: S&P Capital IQ and author analysis.

Research Method

Event Study

The event study is a standard method to measure the effect of new information on stock prices (Binder, 1998). Examples of new information are stock split, dividend initiation and termination, dividend changes, and M&A transaction. There are two event study methods: return after adjusted by benchmark (Binder, 1998) and return without adjustment (Chua, 2014). We use the former methods to measure abnormal return, i.e., return adjusted by benchmark, in the announcement and close date. We eliminate the effect of market movements on the stock price. We use the latter to measure return for the period between announcement and close date. We measure the investor's real experience that holds stock from announcement to close date.

We have three periods under consideration: announcement date, close date, and the period between announcement and close date. We provide the information on the event study period in figure 1 below. The formula for each period is presented in table 3.

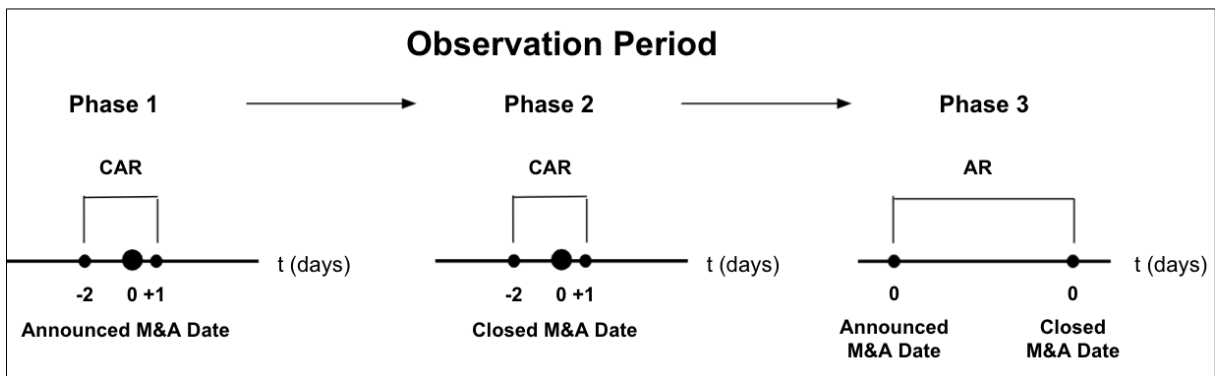


Figure 1. Observation period

Table 3. Description and formula for event study

Description	Abbreviation	Formula
Cumulative Average Abnormal Return Announcement Date	CAAR-A	$CAAR - A = \frac{1}{n} \sum_{i=1}^n \sum_{j=t-2}^{t+1} R_{i,j} - R_{m,t}$
Cumulative Average Abnormal Return Close Date	CAAR-C	$CAAR - C = \frac{1}{n} \sum_{i=1}^n \sum_{j=t-2}^{t+1} R_{i,j} - R_{m,t}$
Average Abnormal Return Announcement to Close Date	AR-AC	$AR - AC = \frac{1}{n} \sum_{i=1}^n \sum_{j=A}^C R_{i,j}$
Return	R	
Announcement Date	A	
Close Date	C	
Individual Stock	i	
Benchmark	m	
Country	j	
Number of Stock	n	

Multivariate Analysis

The hypothesis is tested using cross-section regression. The dependent variable is the average abnormal return on the announcement date, average abnormal return on the close date, and average abnormal return between the announcement and close date. The independent variables are dividend-paying and non-dividend-paying firms, M&A deal value, acquirer's dividend yield, and acquirer's stock valuation. The dividend-paying and non-dividend-paying firms will be represented by a dummy variable with a value of one for the dividend-paying firm and zeroes otherwise. The M&A deal value needs to be normalized because firm size is different. M&A deal value is represented by deal value to the acquirer's market capitalization. The acquirer's dividend yield refers to the dividend to stock price ratio. The acquirer's stock valuation is represented by the price to book value ratio. The empirical model is as follows:

$$ARA_{i,m} = \alpha + \beta_1 dDiv_{i,j} + \beta_2 DealMarket_{i,j} + \beta_3 DivYield_{i,j} + \beta_4 PBV_{i,j} + \varepsilon_{i,j} \quad (1)$$

$$ARC_{i,m} = \alpha + \beta_1 dDiv_{i,j} + \beta_2 DealMarket_{i,j} + \beta_3 DivYield_{i,j} + \beta_4 PBV_{i,j} + \varepsilon_{i,j} \quad (2)$$

$$ARAC_{i,m} = \alpha + \beta_1 dDiv_{i,j} + \beta_2 DealMarket_{i,j} + \beta_3 DivYield_{i,j} + \beta_4 PBV_{i,j} + \varepsilon_{i,j} \quad (3)$$

Table 4. The formula for multivariate analysis

Description	Abbreviation	Formula
Abnormal Return Announcement Date	ARA	$ARA = \sum_{i=t-2}^{t+1} R_{i,j} - R_{m,t}$
Abnormal Return Close Date	ARC	$ARC = \sum_{i=t-2}^{t+1} R_{i,j} - R_{m,t}$
Abnormal Return Announcement to Close Date	ARAC	$ARAC = \sum_{i=A}^C R_{i,j}$
Dummy Dividend-Paying Firm	dDiv	1 dividend-paying firm, 0 otherwise
Acquirer's Deal Value to Market Capitalization	DealMarket	$\frac{Deal\ Value}{Acquirer's\ Market\ Capitalization_{t-1}}$
Dividend Yield	DivYield	$\frac{DivYield_{t-1}}{Acquirer's\ Market\ Capitalization_{t-1}}$
Acquirer's Stock Valuation	PBV	$\frac{Price_{t-1}}{Acquirer's\ Book\ Value_{t-1}}$
Return	R	
Announcement Date	A	
Close Date	C	
Individual Stock	i	
Benchmark	m	
Country	j	
Number of Stock	n	
Error Term	ϵ	

4. RESULTS

The event study shows that dividend-paying firms have a positive short-term wealth effect, as shown by the cumulative average abnormal return on the announcement date. The positive short-term wealth effect is significant alpha 10%. The non-dividend-paying firm does not have a positive short-term wealth effect. The short-term wealth effect is statistically insignificant in the close date and announcement to close date period for both dividend-paying and non-dividend-paying firms. The event study results are presented in table 5.

Table 5. Event Study Results

Event	Event Study Measurement Method	Event Window	Dividend-Paying Firm	Non-Dividend- Paying Firm
Announcement Date	CAAR-A	(-2,+1)	1.30%*	2.69%
Close Date	CAAR-C	(-2,+1)	1.76%	1.54%
Announcement to Close Date	AR-AC	(A,C)	2.94%	-1.64%

***, **, and * significant at alpha 1%, 5%, and 10% respectively.

Notes: CAAR-A is Cumulative Average Abnormal Return Announcement Date. CAAR-C is Cumulative Average Abnormal Return Close Date. AR-AC is Average Abnormal Return Announcement to Close Date.

The multivariate analysis shows that dividend-paying firms have a negative short-term wealth effect and are significant at alpha 10%. M&A transactions provide a positive short-term wealth effect as shown by the ratio of the deal value to the acquirer's market capitalization and acquirer's price to book value ratio. Both variables are significant at alpha 5%. Similar to the event study results, the short-term wealth effect is statistically insignificant in the close date and announcement to close date period. We present the multivariate analysis results in table 6.

Table 6. Multivariate Analysis Results

Variable	Model 1	Model 2	Model 3
Dependent Variable	ARA	ARC	ARAC
Independent Variable			
dDiv	-0.021*	-0.001	-0.032
DealMarket	0.013**	0.009	-0.011
DivYield	0.003	0.002	0.007
PBV	0.005**	0.006**	0.013
R ²	0.071	0.040	0.024

***, **, and * means significant at alpha 1%, 5%, and 10% respectively.

Notes: ARA is Abnormal Return Announcement Date. ARC is Abnormal Return Close Date. ARAC is Abnormal Return Announcement to Close Date.

5. DISCUSSION

The M&A by a consistent dividend-paying firm have short-term negative wealth effects. The consistent dividend-paying firm suggests that the management consistently signals that their interest is aligned with the shareholder interest. The management will choose to maintain their good reputation as a good agent. Hence, the M&A is not motivated to benefit the management at the expense of shareholders.

The M&A short-term negative wealth effects in the M&A announcement date may result from a change in ownership structure. The M&A by the dividend-paying firm change the firm life cycle stages from maturity to growth. The changes are consistent with the non-linearity of the firm life cycle stage (Bhattacharya, Chang, and Li, 2020). The investor has unique investment preferences. The investor who prefers investment in a mature firm with a stable dividend payment may find the firm does not meet the characteristics of a mature firm anymore. Hence, the investor needs to restructure her portfolio by selling the stock position. The investor selling may result in a temporary stock excess supply that depresses the dividend-paying firm's stock prices on the announcement date only. The investor selling of uninvestable stock is widely documented. The findings are consistent with Chen, Shiu, and Wei (2019) study that finds a transient stock price decline for a stock excluded from the MSCI constituent.

However, the M&A negative wealth effect is relatively small than the benefit of changes in the firm life cycle into growth stages, as proxied by deal size and the acquirer's ability to capitalize on the M&A benefits, as proxied by the acquirer stock valuation. A larger deal size has a more significant effect on the firm life cycle stage changes. The acquirer's stock valuation suggests that management can capitalize on the expected benefit from the M&A. Ting, Tebourbi, Lu, and Kweh (2021) that management's ability to deliver

the realization of M&A benefits. The M&A short-term negative wealth effect is relatively small compared to the short-term positive wealth effect of changes in firm life cycles into the growth stage and the acquirer's ability to capitalize on the benefits of M&A. The total M&A short-term wealth effect on the announcement date is positive.

6. CONCLUSION, LIMITATIONS, AND SUGGESTIONS

Conclusion

The research aims to find the M&A short-term wealth effects by a consistent dividend-paying firm. There are conflicting effects. The investor reacts negatively to the M&A announcement by a consistent dividend-paying firm on the announcement date only. However, the investor reacts positively to the M&A announcement because the M&A enables the acquirer to gain favourable performance. M&A enable the acquirer to transition their firm life cycle into growth stages. The higher the deal value relative to the acquirer's stock market capitalization suggests that the life cycle stage transition will be more significant. The acquirer's higher stock valuation shows that management can realize the M&A benefits. The short-term positive wealth effect of M&A deal value on the acquirer's stock market capitalization and valuation is larger than the short-term negative effect from a consistent dividend-paying firm.

Limitation and suggestions

There are two limitations of the research. First, we only measure the short-term wealth effect for shareholders and do not measure the wealth effect for the other financier, i.e. debtholder. There is a possibility that the wealth effect occurs because of wealth transfers from the bondholder to the shareholder (Chen, Ramaya, & Wu, 2020). Second, the acquirer's stock value can be seen in absolute and relative terms. Ma, Whidbee, and Zhang (2019) find that the previous 52 weeks' stock price influences shareholder activism. When the stock price is significantly below the 52 weeks price, the M&A announcement experiences more significant positive effects. Based on the research limitations mentioned above, we suggest future research to address the entire firm's wealth effects and consider the previous 52 weeks' stock price.

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