

# Abnormal return and the characteristics of merger and acquisition in Indonesia

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## ABSTRACT

Indonesia also have experienced the practice of Merger and Acquisition (M & A) transaction, like other parts of the world. This study aims to see if there are abnormal returns for the acquirer companies in M & A transactions that occurred in Indonesia, and also to test if there are some characteristics related to M & A that affects the abnormal returns. This study uses 143 M & A transaction data public company in Indonesia in 2005 until 2014. Event-study analysis was also conducted to find acquirer abnormal stock return around the announcement of M & A. In addition, OLS regression was also conducted to find whether the cash payment method in the M & A negatively affects the abnormal return. The conditions of companies (Net Profit Margin, Sales Growth, Firm Value) also affect the abnormal return. This shows that the method of payment and acquire companies' conditions have effects on the perception of investors towards M & A transactions that occurred.

## ABSTRAK

Indonesia tidak luput dari fenomena gelombang Merger dan Akuisisi (M & A) yang melanda dunia. Penelitian ini dilakukan untuk melihat apakah terdapat abnormal return bagi perusahaan pengakuisisi, serta melihat faktor-faktor yang mempengaruhi abnormal return tersebut. Penelitian ini menggunakan 143 data transaksi M & A perusahaan publik Indonesia yang terjadi selama tahun 2005 hingga 2014. Hasil analisis menggunakan metode event-study, menunjukkan adanya abnormal return saham perusahaan pengakuisisi di sekitar pengumuman M & A. Selanjutnya, hasil regresi OLS menemukan bahwa metode pembayaran kas dalam M & A berpengaruh negatif terhadap abnormal return tersebut. Selain itu kondisi perusahaan pengakuisisi (seperti net profit margin, sales growth, firm value) juga ikut berpengaruh terhadap besarnya abnormal return. Hal ini menunjukkan bahwa metode pembayaran dan kondisi perusahaan pengakuisisi memiliki pengaruh terhadap persepsi investor terhadap transaksi M & A yang terjadi yang apa akhirnya mempengaruhi harga saham.

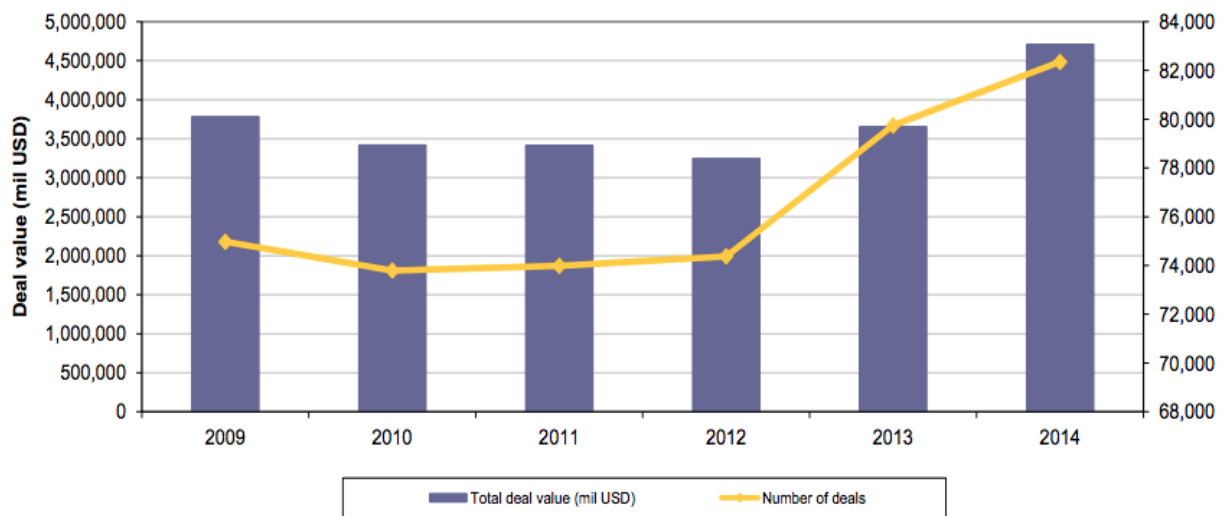
## 1. INTRODUCTION

One of the strategies employed by the company is by growing and improving their competitiveness in the increasingly dynamic environment. It is done using mergers and acquisitions, in this, it is abbreviated to M & A (Mayrhofer 2004). When viewed from the growing trend of global M & A transactions, a few from 2009 to 2014 of their transaction had increased the value of M & A as demonstrated in Figure 1. M & A were chosen because these strategies are considered incurring

the costs in the process and they are much smaller than the potential value that can be created from the mergers (Shah & Arora 2014). Nevertheless, M & A does not always end with success, due the steps of restructuring, in which they can face potential obstacles, the problem of integrating two large companies with their complex culture, structure, and different operating systems (Haspeslag & Jemison 1991),

Uncertainty about the results of an M & A led to the announcement of M & A that sometimes the

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**Figure 1**  
Trend of the M & A Global Growth in the Period of 2009-2014

Source: Zephyr database 2015

shareholders receive the signal differently. M & A could be accepted as either positive or negative strategy in varying quantities, depending on the investors' perception towards the company's ability to generate their added value. Several previous studies have been conducted to see the effects of M & A on the value creation for the acquirer or the company acquiring the other one by looking at the movement of the value of its stock around the time of the announcement of M & A (i.e. Ma, Pagan & Chu 2009; Wong and Cheung 2009; Shah and Arora 2014). Some studies have also further seen the effect of M & A-related characteristics on stock price movements around the time of announcement (ie Fuller, Netter & Stegemoller 2002; Bhabra and Huang 2011; Isa & Lee 2011, Bouzgarrou & Louhichi 2014). Empirical evidence from studies that have been carried out related to M & A still show different results.

Studies related to M & A in developing countries started are in line with the increasing role of developing economies on the world economy and the advent of the phenomenon of M & A in developing countries (i.e. Ma, Pagan & Chu 2009; Wong and Cheung 2009; Bhabra & Huang 2013; Isa and Lee 2011; Shah and Arora 2014). However, research on the effect of M & A on the companies involved in such activities in Indonesia is still very limited. As such, there are only a few studies that have attempted to see the impact of M & A on the value of the acquirer, but this study has yet to explore further on the characteristics of the M & A of the abnormal return that has happened.

Given the limited research related to the effect of M & A activity in Indonesia, this study tries to fill the existing gap. This research aims to look at the effect of the announcement of M & A on stock price movements of the acquirer. Furthermore, this study aims to analyze how the characteristics of an M & A (firm-characteristic and deal-characteristic) and the effect on the abnormal returns occurred in the shares of the acquirer.

There are several reasons why the study was done such as the first, many of the M & A in Indonesia and the number is predicted to continue to rise. Specifically, the Bloomberg database was recorded with 858 M & A transactions that occurred in Indonesia in 2005. Second, this study looks at how the company's ownership structure with their roles acquires the companies affect stock value changes. The ownership structure is included in the form how the government and foreign ownership affect the outcome of M & A.

## 2. THEORETICAL FRAMEWORK AND HYPOTHESES

The terms of mergers and acquisitions are often used interchangeably, even though both have slightly different meaning. Merger is combinations of two or more companies, with one of the names of companies who join remain in use while the other is eliminated. On the contrary, the acquisition is defined as the process of taking over ownership or control of the assets or shares of another company, in this event both companies of the acquirer or taken to exist as a separate legal entity. However, the end results of mergers and acquisi-

tions are relatively similar. Two or more companies that have different ownership finally operated as the company after the M & A (Sherman & Hart 2006). This research did not use the terms of mergers and acquisitions differently and defining the M & A transactions as acquirer agreement which leads to increase its stake in a company to more than 50% (Moeller, Schlingemann & Stultz 2004; Ma 2009 Pagan & Chu)

M & A activity has multiple purposes ranging from increased market share, product diversification, acquisition of technology; reduce risk, innovation, up to increase their competitiveness (Jensen 1993; Andrade, Mitchell and Stafford 2001). Yet, M & A activity can also be influenced by external conditions (such as the form of acquisition), changes in technology, and changes in the regulatory or personal interests of the directors which would normally result in a bad acquisition (Martynova & Renneboog 2008).

#### **Return of the Stocks and Special M & A**

Announcement of M & A provides information that can generate market reaction. This can be used as a good indicator for future success. The market reaction that occurs against an announcement of M & A is a form of investors' perception towards the company's ability to generate a higher return in the future. This perception can affect the investment decisions by the investors in the future.

Many studies have been done to see if the M & A really brings the expected results. One of the research groups tried to see if there is a change in the value of shares between the announcements of the stock. To measure the economic impact of an event, in this case, the market reaction to the announcement of M & A, can be used a measure called as abnormal return. Abnormal return is the difference between the returns actually happened (actual return) minus the expected return (expected return) and is calculated throughout the period of the study (Mackinlay 1997).

Research by Martynova & Renneboog (2008) analyzed 65 previous studies of their abnormal returns around the date of the transaction. No empirical results can conclude whether the M & A could deliver the value to the acquired companies. Most of the acquired companies obtained additional sizeable value of M & A. Yet, the effect of M & A on the acquirers provides different results. Some companies could earn a positive abnormal return in small numbers while others suffered minor losses.

#### **Characteristics of M & A and Abnormal Return**

Some previous studies also found the effect of M & A transactions on the acquirer abnormal return after the announcement. Some characteristics are such as linkage industries (Bhabra & Huang 2013; Cefis & Rigamonti 2013), method of payment (Sherif 2012; Dutta, Saadi and Zhu 2012) funding sources (Bouzgarrou and Louhichi 2014), the companies being acquired (Isa and Lee 2011; Bhabra & Huang 2013, and this got the attention from other similar previous studies.

Another study was by Bhabra and Huang (2013) with the use of 136 M & A transactions during the period 1997 to 2007 from the company- the companies in China listed in Shanghai and Shenzhen Stock Exchanges. It indicates that the Company acquirer had positive abnormal return significantly around the announcement date and continued until the third year after the announcement of M & A. It also found that the industry association provides a positive and significant effect on the stock performance of the acquirer. It even also found had an effect on the ownership structure of the acquirer (SOE). It has an effect on the returns received around the date of the announcement of M & A.

One of the factors that are considered influential is the industry association of companies involved in M & A. When a company wants to take a step for acquisition, the industry linkages are important factors that should be considered. Industry linkages describe the extent to which the two companies are active in the industry and related markets (Ellwanger and Boschma 2015). The potential problems that often arise from the acquisition of unrelated industries are related to the limitations on knowledge management of each business and each market. This is due to the condition that they only rely on management and financial control. This led to the inability of management to evaluate the accuracy of the strategies chosen by the managers in each business. Financial control often results in short-term orientation for managers at the business level. This also leads to the negative results for the acquisition between companies' unrelated diversification (Cefis and Rigamonti 2013).

Isa and Lee (2011) examined all M & A deals by non-financial companies listed on the Malaysian stock exchange from 1 January 2000 to 31 December 2004. The research looked at the target status as one of the variables that affect the acquirer abnormal return. The result of this study indicates that the acquisition of public companies

generated abnormal returns that were higher for the acquirer rather than the acquisition of the private companies. In addition, the results also showed that the overall payment, the M & A used the cash to get abnormal return that is better than the payment on the shares. Research by Dutta, Saadi and Zhu (2012) using data from the 1300 M & A transactions (local and inter-state) by the acquirer owned by Canada during 1993 -2002 also showed a positive effect and significance of the use of the method of payment for the shares of the abnormal return on the shares of the acquirer.

Other studies found in a different conclusion. Sherif (2012), conducted a research in the UK using the 68 M & A transactions, with 33 of them using shares and 35 using cash. The study concluded that payment for shares generate a significant and negative abnormal return during the announcement of M & A. Abnormal lowest returns were also obtained at the time of payment M & A using shares. But, the cash into a payment option that gives the best results.

Research by Martynova, M, & Renneboog, L 2011 in the UK and some European countries; show that the status of private or closed companies from the target companies has a positive relationship with abnormal return of the acquirer. Besides that, the payment by using stock returns causes a decline in the acquirer.

In contrast with the results obtained by Bouzgarrou and Louhichi (2014) to 265 M & A recorded in France the period 1997 to 2008 to add a means of financing in the analysis of research because of the three methods of payment did not show a significant effect on stock returns of the acquirer. Research results revealed that the source of financing by M & A has more effect on the degree of abnormal returns. M & A that was financed by debts outperformed the M & A that was financed by other financing.

### 3. RESEARCH METHOD

#### Data of the Analysis

This is an empirical study, using secondary data obtained from Eikon database, Bloomberg databases, Indonesia Stock Exchange (IDX) database and annual report of the companies published. The sample consisted of 143 M & A transactions

by public companies listed on the Indonesia Stock Exchange and performed in the period 2005-2014. The M & A transaction data were to be used in a transaction that had already completed the process or recorded in a completed status. Then, carefully it studied in every transaction to find more detailed information including the date of the announcement of M & A, the method of payment used, industry classification of the acquirer and the target company was clearly known by Standard Industrial Classification (SIC) Code and the stock price data obtained 77 transactions to meet the criteria and have complete information for the analysis process.

Through Bloomberg database, the study got information on M & A list of events, which occurred in the period 2005-2014 following the payment methods in the M & A transactions. But, the complete information concerned the M & A transactions such as the name of the company involved, the date of the announcement, the effective date, the value of M & A transactions, the status of the companies involved (subsidiary, joint venture partners, private, government-owned or public companies), as well as industry classification obtained from Eikon.

The study got the information about the price of the companies' shares traded on the Stock Exchange every day, the price change from day to day, and the change in stock price index (CSPI) from the database Indonesia Stock Exchange (IDX). All these could be obtained were obtained from the financial statements of the sample companies.

#### Research Model and the Variables

The event method in this study was used to look at the movement of shares in companies being acquired and to calculate cumulative abnormal returns that come as a result of market reaction to the announcement of M & A. The abnormal return is the short-term financial performance indicators that describe the movement of shares of the companies. This is as a result of market reaction to the announcement of M & A. In addition, the abnormal return can be calculated as the difference between the actual return and the expected return.

**Table 1**  
**List of Research Variables**

No	Variables	Notation	Measurement
1	Cumulative Abnormal Return	CAR	The accumulated abnormal return value for the event windows (5 days) which were used
2	Net Profit Margin	NPM	The degree of profit margin (net of interest expense and taxes) on the sales in one year prior to the announcement of M & A
3	Sale growth	SG	Percentage of change in sales that occurred in the period compared with the previous period in one year prior to the announcement of M & A
4	Leverage level changes	$\Delta lev$	Percentage of the change of debt to total asset ratio
5	Companies' Value	FV	Companies' values of the acquirers is measured by using the natural logarithm of the market value of the acquirer in the announcement of M & A
6	Cash Method	DumKas	Dummy variable, equal to 1 if the method of payment on an M & A transactions conducted by using cash, while 0 if not equal.
7	Non-Public	DumNon-Public	dummy variable equal to 1 if the target company is a private company that is not listed on the Stock Exchange, while 0 if it represented a public company listed on the Stock Exchange
8	State-Owned Enterprises/ companies	DumSOE	Dummy variable, equal to 1 when the acquirer is a state-owned enterprises, while 0 if the acquirer has other ownership structures.
9	Industry association	DumInd	dummy variable, equal to 1 if there is a connection between the acquirer's industry and target companies seen from the first 2 digits of the Standard Industrial Classification (SIC) Code, whereas 0 if it has no industry association

This study used a 5-day window period (-2, + 2) and 3 days (-1, + 1), which was centered on the date of announcement of the acquisition (Ma, Pagan & Chu 2009; Sherif 2012). The use of a relatively short time span was meant to improve the accuracy because it could reduce the likelihood of introducing market reaction caused by other events (MacKinlay 1997). Furthermore, the regression model Ordinary Least Square (OLS) was used to test the effect of variables related to firm-characteristics and deal-characteristics suspected to affect the abnormal return that was happening. The calculation of cumulative abnormal return (CAR) was performed using 5-day window period.

The companies' are the related independent variables characteristics were based on performance indicators and companies' values of the acquirers (Bhabra and Huang 2013). While the other independent variables related to the characteristics of M & A. The details of the operation of the variables used can be seen in Table 1.

The abnormal return was calculated by using the market adjusted model (Ma, Pagan & Chu 2009; Bhabra and Huang 2013). Next, is the expected return in the method of the same model was used with the market adjusted market index return. By using the market adjusted model, it is

not necessary to use the estimation period, because the return of securities to be estimated is the same as the market index return. In addition, the use of this model can also avoid potential contamination in the estimation period due to the multiple acquisitions.

Mathematically, the regression equation for this study can be written as the following:

$$CAR = \alpha + \beta NPM + \beta SG + \beta \Delta lev + \beta \log \frac{FV}{FV} + \beta DumInd + \beta DumSOE + \beta DumKas + \beta DumNon - Public + \varepsilon \quad (1)$$

Where,

CAR = Cumulative Abnormal Return

NPM = Net Profit Margin (NPM)

SG = sales growth

$\Delta lev$  = change in leverage

FV = Market value of the company (company Value)

DumInd = dummy variable of industry

DumSOE = dummy variable of state-owned enterprises (companies)

DumKas = The dummy variable of the method of payment by Cash for M & A

DumNon-Public = dummy variable for target public companies.

#### 4. DATA ANALYSIS AND DISCUSSION

This study aimed to determine whether the an-

**Table 2**  
Descriptive Statistics

Variables	Maximum	Minimum	Mean	Std Deviation
CAR(-2,+2)	70.07406	-45.45714	4.170329	16.50445
NPM	78.38	-102.66	13.70338	20.72956
Change in leverage	74.38293	-38.09149	4.422348	14.50242
Sales growth	166.35	-99.09	24.44364	40.51913
Ln_FV	19.27685	11.25156	15.79583	1.662998
DumInd	1	0	0.45455	0.50119
DumSOE	1	0	0.10390	0.30713
DumKas	1	0	0.89610	0.30713
DumNon-Public	1	0	0.26866	0.42600

Source: Processed data.

**Table 3**  
Test of the Correlation

	NPM	Change in Leverage	Sales Growth	Foreign Company Values	One-Industry	Cash	State-Owned Companies	Non-Public (Target)
NPM	1	-0.33734	0.38667	0.21769	0.13778	0.02298	0.0723	0.12108
Change in leverage	-0.33734	1	-0.38209	-0.05575	-0.10694	0.23420	-0.08070	0.23237
Sales growth	0.38667	-0.38209	1	-0.11392	0.17442	-0.20748	-0.02781	-0.10596
Foreign Companies Value	0.21769	-0.055745	-0.11392	1	0.16209	0.16916	0.25254	0.06787
One-industry	0.13778	-0.10694	0.17442	0.16209	1	-0.03108	0.116563	-0.07283
Cash	0.02298	0.23420	-0.20748	0.16916	-0.03108	1	0.115942	-0.21420
State-owned companies	0.07230	-0.08070	-0.02781	0.25254	0.11656	0.11594	1	-0.08751
Non-Public (target)	0.12108	0.23237	-0.10596	0.06787	-0.07283	-0.21420	-0.08751	1

Source: Processed data.

nouncement of M & A produces a reaction of the market and has information content, as measured by abnormal return by the acquirer- companies around the date of the announcement of M & A. This study more specifically attempts to see the factors that affect the acquirer abnormal returns by testing the variables related to the companies' characteristics and deal-characteristics.

### Results of the Event Study

Event study method was used to see whether there is an abnormal return around the announcement date and how much it is. Cumulative Abnormal Return value during the period was used as an indication of whether M & A provide added value to the acquirer. The average values of CAR for the period of three days were around the time of the announcement (-1, + 1) of 0.0408 with a standard deviation of 0.1351. The 5-day period around the time of the announcement was (-2, +2)

of 0.0414 with a standard deviation of 0.1653.

The result of the event study analysis shows that due to the announcement of M & A acquirer, it can gain a positive abnormal return either by using a period of 3 days or 5 days around the time of the announcement. This result is consistent with several previous studies that also showed a positive effect of M & A against the acquirers, even though the amount that was not high (Ma, Pagan and Chu 2009; Bhabra and Huang 2013).

### Results of the Regression Model

This study used regression models Ordinary Least Square (OLS) to determine the factors that affect the cumulative abnormal return acquirers around the date of the announcement of M & A by examining the variables related to firm-characteristics and deal-characteristics of M & A. The activities are those that occurred during the study period. The market's reaction can also be

**Table 4**  
**Results of the OLS Cross-Sectional Regression**

Variables	Coefficients	p value
C	65.20066	(0.0007)
NPM (pra)	0.260291**	(0.0134)
Change in leverage	-0.060249	(0.6822)
Sales growth (pra)	-0.152011*	(0.0047)
Company Value	-2.787262**	(0.0198)
One-industry (dum)	-1.443869	(0.6935)
State-onwed companies (dum)	1.978566	(0.7420)
cash (dum)	-16.07188**	(0.0157)
Private (target) (dum)	-6.546518	(0.1659)
R <sup>2</sup>		0.231642
Adjusted R <sup>2</sup>		0.141247
Prob (F-statistic)		0.016657

Source: Processed data.

\*significant statistically at the significance level of 0.01

\*\*significant statistically at the significance level of 0.05

\*\*\*Significant statistically at the significant level of 0.10

seen from the cumulative abnormal return obtained by the company on a five-day window period that can be reflected by the CAR (-2, + 2).

OLS was used for the data provided a cross-section data. M & A activity that occurred in the sample companies occurred only once and is not a periodic as they are events, so that the data is not the available panels.

Classic assumption test was done to determine whether the regression model has a condition Best Linear Unbiased Estimator (BLUE) in the form of normality test (test Jarque-Bera), heteroskedacity (white-test), the auto-correlation (test Breusch-Godfrey or LM Test) and multicollinearity (correlation test). The results of the tests carried out showed that the regression model was in a BLUE state or free from problems such as heteroskedacitycity autocorrelation and multicollinearity.

This study used descriptive statistical tables to provide an overview of important information and data from the distribution. It covers the minimum value, maximum value, average value, and standard deviation (Table 2). The average value of CAR (-2, + 2) the acquirer in M & A was recorded in the period from 2005 to 2014 amounted to 0.0414 with a standard deviation of 0.1653. Standard deviation is higher than the mean values and this shows a high variation or a considerable gap between maximum and minimum values. The average value of CAR (-1, + 1) of 0.0408 indicates that as a result of the announcement of M & A acquirer, it can obtain the cumulative abnormal

return by 4:08 percent with a standard deviation of 0.1351.

Table 3 presents the results of testing of the multicollinearity to 10 independent variables used in the study where if all variables proved to have multicollinearity on this test, corrective measures should be done to eliminate the multicollinearity between the variables. Based on the test results of multicollinearity, it can be seen that there is no correlation between the variables of independent views of the degree of correlation coefficient values in each column. Two variables are said to be correlated if the coefficient correlation value exceeds the value of tolerance of 0.80. It can also be seen that the values of the coefficient in each column as shown in Table 3. There are none whose value exceeds 0.80.

The coefficient of determination was used to see to what degree the independent variables are together able to explain the dependent variables. The regression results can be seen in the Table. 4. Adjusted R-squared value of 0.1413 means that all independent variables can only explain the variation that occurs in the dependent variables by 14.13% while the rest is explained by other variables outside the model used in this study. Values that are with lower adjusted R2 are often found in research that involves short-term performance measures to gauge market reaction to the announcement of M & A. This is because the short-term performance as measured by the stock often is more influenced by the quality of information (often asymmetric) received by the market so the

impact on market inefficiencies.

The regression results show that the hypothesis which states that the NPM is significantly positive effect on CAR acquirers around the announcement of M & A could be accepted. Companies with relatively high NPM investors were believed by the company to manage the result of M & A is better. These results are consistent with research Bhabra and Huang (2013). NPM reflects the company's ability to control and reduce costs to generate higher profits. Therefore, it can be said that this ratio can describe management capabilities in managing the business. This, in turn, increases the confidence of investors to invest their funds

The sales growth has a significant effect negatively on CAR of the acquirer. Some explanations may be proposed that it is because the motive of M & A that is more influenced by motives of the agencies that have an impact on the welfare losses of shareholders. They did not focus on value creation through synergies that can generate economies scale and expansion of market share. Thus, they affect the negative reaction generated as a result from the announcement of M & A (Bhabra and Huang 2013).

The company value has a significant effect negatively on CAR of the acquirer. This negative effect indicates that the announcement of M & A is translated as a negative signal to the market that might be due to market participants that doubt the company will be able to increase their market value after M & A. This could potentially lead to changes in the various aspects of a company

The regression result also showed that the M & A with a cash payment method has a significant effect negatively on CAR of the acquirer in a five-day window period. This shows that M & A, which is repaid using the cash, is seen as a negative signal by the market participants. Payment by cash tends to increase the debt (considering that the debt is one way of funding to selected companies) to be borne by the acquirer after the M & A. This debt burden is at risk of a negative impact on the performance of the company in the post-acquisition period. This, ultimately, reduces the wealth of shareholders. It can be a negative signal for market participants on an M & A. Differences of payment option has different consequences for shareholders of the company.

The study on acquisition explains that in the displacement of cash transactions, the ownership is characterized by the exchange of cash for the company's shares target. This may be a negative

signal for the cash transaction which does not have any risk of sharing where the risk is borne entirely by the acquirer. It sends a negative signal to investors that consider high-risk corporate action and this can be risky in a loss of profits of companies which is resulted in investor losses.

## 5. CONCLUSION, IMPLICATION, SUGGESTION, AND LIMITATIONS

This study is in relation to the analysis of the factors related to firm-characteristics and deal-characteristics that affect the acquirer's abnormal stock returns around the announcement of M & A using the event study approach and cross-sectional OLS regression. It was found in the event study analysis, that there is cumulative abnormal return around the announcement of M & A. The study also found that the Net Profit Margin (NPM), Sales Growth and companies' value of the acquirers significantly affect the degree of the CAR. NPM has consistently shown a significant and positive effect on CAR of the acquirer, while Sales Growth and company value has a significant and negative effect on the CAR of the acquirer. The cash payment method also has a significant and negative effect on acquirer. This means that M & A that is financed by the cash generating CAR is lower when compared with other payment methods. This also indicates that the cash payment method is considered a negative signal by the market players.

Overall the model used, this study can only explain the factors that affect the CAR of the acquirers around the date of the announcement of M & A. The market's reaction shows high variation that likely the CAR indicates the stock is difficult to explain by certain variables other than market sentiment. It is indeed the decisive events of the good and bad reaction to the announcement of the acquisition.

It is advisable for other researcher in further studies, to see again the effects of industry structure on the presence of abnormal returns in M & A activities. This is because the structure of the industry is also considered influential on the M & A and its success.

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