

CHAPTER I

INTRODUCTION

1.1 Research Object

The object of this research is the telecommunications firms around Asia Pacific countries which conducted mergers and acquisitions over the period from January 1, 2011 to December 31, 2014. There are 24 out of 48 countries surrounding Asia Pacific that have stock market. However, this research will examine the Asia-Pacific countries including: Australia, Hong Kong, Indonesia, Japan, Malaysia, Philippines, Singapore, South Korea, and United States. These countries have some telecommunication companies that conducted merger and acquisition over period 2011-2014. The total number of telecommunication companies that conducted mergers and acquisition are 14 bidder companies; while there are 17 M&A announcements which include 1 merger and 16 acquisitions have been announced that are suitable with the author's research object criteria. The list of 17 M&A announcements analyzed in this research can be seen in Table 1.1.

Table 1.1 Research Object

No.	Country	Telco Company (Bidder)	Target Company
1	Australia	BigAir Group Ltd.	Oriel Technologies
2		Inabox Group Ltd.	Anittel Group Ltd.
3		TPG Telecom Ltd.	Intra Power
4			Telecom New Zealand Australia
5	Hong Kong	China Telecom	China Telecom Corp-3G Assets
6	Indonesia	XL. Axiata Tbk.	PT. Axis Telekom Indonesia
7		PT. Tower Bersama	PT. Mitrayasa Sarana Informasi

No	Country	Telco Company (Bidder)	Target Company	
8	Japan	NTT Group (Nippon Telegraph and Telephone)	Ragingwire	
9	Malaysia	Telekom Malaysia Berhad	Packet One Network Sdn. Bhd.	
10	Philippines	Liberty Telecoms Holdings, Inc	Ziggo	
11	Singapore	Singapore Telecommunications Ltd	Amobee	
			Advanced Info Service Public Company	
12	South Korea	SK Telecom	Shopkick	
			Hynix Semiconductor Inc.	
13	United States	AT&T	DirecTV Inc.	
14			North State Telephone Company	
15			Cincinnati SMSA and Cincinnati SMSA Tower Holdings	
16			Verizon Communications	Verizon Wireless
17			Level 3 Communications	Global Crossing Ltd.

Continue from Table 1.1

Sources: Processed secondary data

1.2 Research Background

The telecommunications industry has undergone far-reaching change since the second half of the 1980s (Levine, Pitt, & Pinto, 2000 in Fernandez et al., 2011). The telecommunications sector is a quite competitive industry which forces the companies to keep enhancing their strategy to survive in the market. Many industries are trying to expand their business through mergers and acquisitions (M&A) which is considered as an essential business strategy that creates value for shareholders and achieve commercial objectives. There are several types of merger and acquisition in which

every company conducted different M & A type in accordance with the motives of merger or acquisition. Meanwhile, M&A for telecommunications sector itself, Akrofi (2014) examined that “mergers and acquisitions in the Telecommunications Sector are mostly horizontal mergers simply because the entities involved operate in the same industry, that is the telecommunications industry, and also on the same product lines”. Most probably, these strategic are chosen in order to affect shareholder value of companies (Ernst Halevy, 2000 in Abdi et al., 2001). Moreover, Gaughan (2011) stated that there are two most prominent motives for doing mergers and acquisitions: faster growth and synergy.

An example of using M&A to facilitate growth is when a company wants to expand to another geographic region (Gaughan, 2011:126). “It could be that the company’s market is in one part of the country but it wants to expand into other regions” (Gaughan, 2011:127). Moreover, the M&A are often looked as an opportunity to jump-start growth. It is considered when the demand of the market towards its products and services is relatively slow that makes the company confronts difficulty to continue to grow. As such it is a common practice for companies to conduct M&A activities with another firm. Besides the growth related to the firm’s motive in the M&A, Gaughan (2011) also examines the types of synergy that can be attained through M&A. These are operating synergy and financial synergy. Operating synergy aims to derive revenue enhancement and cost reduction. The companies seek for the possibility to decrease the cost of capital when one or more companies are combined.

Several studies regarding the impact of merger and acquisition have been conducted by some researchers and their results differ from one researchers to another. Refer to Abdi et al. (2001) who found that from the observations of 60 companies involved; including target companies and acquirer companies for each; “the total results indicate that the target companies earned positive CAR (Cumulative Abnormal Return), while shareholders of the acquirer/bidder companies showed negative CAR, at the time the deals were announced”. From the statistics calculation, it shows that the

target companies increase shareholder value, while the acquirer/bidder companies destroy shareholder value (Abdi et al., 2001). Conversely, another research results in negative CAAR (Cumulative Average Abnormal Return) for target firms during the pre-announcement period, the announcement period, and the post-announcement, thus there is no abnormal return on target firms at the time surrounding the announcement period (Wong, 2011). Meanwhile, the negative abnormal return also occurs in bidding firms (Delaney and Wamuziri, 2004).

In Asian market, M&A contributed a crucial role in leading the companies to grow, since most of countries in this region are still developing countries. As stated by Scott W. Minehane in ITU-MCMC International Training Program 2015 held in Kuala Lumpur that encompassed competition issues related to mergers and acquisitions “M&A have taken a formative role in shaping the Asian telecom market-by allowing national carriers to grow within domestic and regional sectors”. The importance of M&A activity is also felt by European and other regions, especially in telecommunications sectors. Moreover, a high profit deals were expected to be earned by Asia-Pacific markets in technology, telecommunication, media and entertainment and consumer as reported by Intralinks Deal Flow Indicator that show global M&A deals in Asia-Pacific up 18% for the year 2014.

In 2014, more than \$2.5 trillion worth of M&A deals have been announced that examine 30% increase on \$1.9 trillion. It is boosted by the value deals of above \$10 billion which is telecommunication sectors became one of primary sectors that conducted mega M&A deals in 2014. As can be seen in Figure 1.1, the number of M&A transactions are continuously declining in 2010-2013; however, it started increasing in 2014 with the number and value of transactions are 12,428 and \$844 billion respectively.

According to WilmerHale MA Report, “global telecommunications sector increased 11%, from 696 deals in 2012 to 775 deals in 2013”. In 2012, the largest telecommunications M&A deals was driven by Softbank’s acquisition of Sprint and

China Telecom’s acquisition of the CDMA Network from its parent (Redwood Capital, 2014:2). Refer to the possibility of the existence of abnormal return surrounding the M&A’s announcements, there is an evidence that the share prices are increasing due to the acquisition announcement. For instance, the M&A announcement event caused the “investors reacted positively to the deals TPG shares surged as much as 16% before finishing the day, 13.6% higher at 4.68” as reported by The Sydney Morning Herald in 2013 (Mason, 2013). An increasing in the shares price also occurred in Tokyo trading after KDDI Corporation announced a buyout plan of Jupiter Telecommunications Co. The investors experienced the biggest gain since March 2016 in which the carrier surged 5.5% to 6,370 yen at the close of trading in Tokyo (Bloomberg).

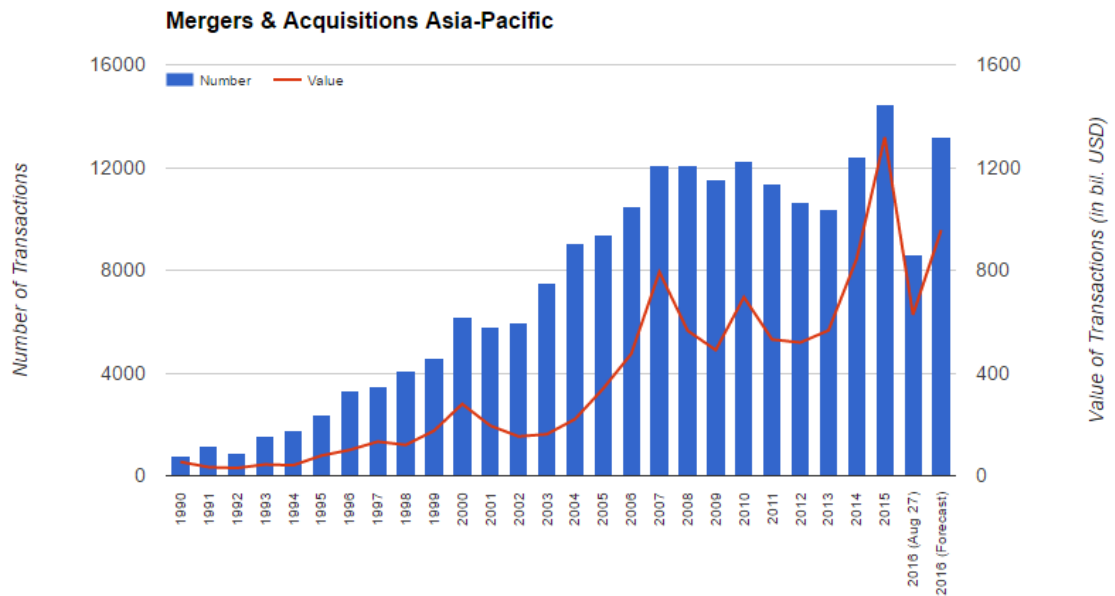


Figure 1.1 Number and Value of M&A Asia-Pacific

Source: IMAA

The announcement of mergers and acquisitions can affect the market’s reaction. As a result, the share prices can fluctuate during the M&A time period. The return of the sales as one of indicators to measure shareholder value. Besides the return of the

shares, since innovative events in high-tech firms are often extremely uncertain and the economic value thereof is highly unpredictable, investors may well interpret such announcements in a variety of ways, causing increased price volatility (Liu, 2000 in Fernandez et al., 2011). Furthermore, the event study to measure the announcement effect towards share return is commonly used by analyzing the abnormal return.

In this research, the author will use the share returns and trading volume as indicators. It relates to the goal of corporate that obviously to pursue shareholder value maximization, in which every investor will seek the profit from the return either in long-term or short-term investment. As defined by Bistrova and Lace (2012), the value creation of the company for its stakeholders and shareholders are dividend payments and stock price appreciation. The mergers and acquisitions announcements that become the event study are analyzed as this corporate action heavily relates to the goal of the company in order to maximize the shareholder value. This event can lead to the investors' reaction as the M&A is seen to enable the company to raise the profit and will also effect to an increasing of share prices. Nevertheless, it is not simply to put the statement that M&A would always lead to an increasing share prices as each investor has different reaction and projection towards the effect of M&A. It could even result in decreasing share prices if the M&A is seen does not have a good prospect to company' growth. Thus, the investors may react negatively on this M&A event. This negative reaction of investors will also affect the volume trading as less investors are interested in buying its shares.

To recall the issues regarding the M&A and its relation to market reaction, the abnormal return will be calculated to know whether there is a significant difference on return of share prices as measurement of shareholder value caused by certain event which is M&A announcements. There are several methods to calculate abnormal return: Mean Adjusted Model, Market Model, and Market Adjusted Model. While, in this study market model will be used to estimate expected returns since the other models does not reflect the fair and constant normal returns of the firms in the M&A

announcement in the estimation period as against the market index in the market model (Shah and Arora, 2014) and also market model is the most appropriate model to conduct daily event period as the estimation return model will be derived from daily market return.

Additionally, the importance of firm's characteristics such as age, profitability, and leverage are also included in this research as those factors are part of corporate disclosure; nevertheless, "less attention has been paid to the influence of firm-specific determinants on the effects of corporate disclosure in capital market" (Fernandez et al., 2011:4). Before deciding to buy some stocks, the investors usually conduct both fundamental and technical analysis. Refers to McClure (2010), the fundamental analysis is the cornerstone of investing. In fundamental analysis, it includes quantitative analysis that can be measured by looking at company's financial statement. This is the most important one that investors should know. It involves looking at revenue, expenses, assets, liabilities and financial ratios. Profitability is often seen as one of the most attracting aspect by the investors. When the company has a good performance record on generating profit, the investors are interested to invest as they expect to get positive returns on its stock. This relates to the purpose of M&A to achieve financial synergy. Meanwhile, another financial ratio that will be used is debt ratio to measure the financial leverage. The greater financial leverage is measured by a higher debt a firm uses in relation to its total assets. (Gitman and Zutter: 2012). A related leverage finding examines that leverage create value for buyers (Campa and Hernando, 2002). The more companies use the fixed-cost debt, the investors will expect a higher risk and return.

Besides these financial performances, the analysis regarding the age of the company has been conducted by various research. Refers to Fernandez et al. (2011:5), some research that has been conducted previously examine that ".....the less mature the firm, the more important the discretionary information will be". This is because the projection of future growth for less mature companies are still uncertain compare to

the company that has already been in this business for a long time and has its position in the market. More information is needed by investor to have a better clue for young firms to grow. Usually, the company that is still young or starts-up is more focusing on marketing strategy to attract new investors. In this case, when the company conducted mergers or acquisitions, they published the announcement more frequent than mature or older companies. Nevertheless, Subramanian et al. (2006) in Fernandez et al. (2011) do not find evidence of a significant relation between the firm's age and abnormal return. Therefore, both financial ratios (profitability and debt ratio) and the age of the company are also involved in this research.

Despite of the number of M&A deals are increasing, the studies related to M&A occurring in Asian and resulting abnormal return in Asian markets are still few due to the market is considered as still an emerging market (Ma et al., 2009; Wong, 2009). However, the process of global economic integration and excellent economic performance of some Asia countries attract both investors and academicians (Wright et al., 2005 in Ma et al., 2009). It is also interesting to analyze the country surrounding Asia-Pacific countries since the M&A in telecommunication sectors in US and Australia have some big telecommunication companies such as AT&T, Verizon, TPG Telecom, and BigAir Group that conducted a huge M&A's value deals. Refer to the statement above and issues finding regarding to the market reaction to merger and acquisition strategy, the author is interested in conducting a research with the title: **“Market Reaction towards Mergers and Acquisitions Announcement in Telecommunication Firms listed in Asia-Pacific Stock Markets”**.

1.3 Problem Formulation

There is a difference between the theory and the research findings regarding the impact of mergers and acquisitions on market value. The theory stated that mergers and acquisitions enable the acquire companies to gain a positive result in an increase of share prices as one of measurement for shareholders value. This strategy maintains

the creation of shareholders value prior to commercial objectives which means the announcement of M&A has a significant impact on the different share return before and after its announcement. In contrast to the theory, previous researcher examined that announcement of merger and acquisition resulted in negative return and do not affect the return (Abdi et al., 2001; Wiriastari, 2010; Sugiarto, 2000).

This research aims to reanalyze the shareholder value creation of the firms involved in mergers and acquisitions surrounding its announcement measured by abnormal returns. Moreover, the firms' characteristics and their impact on volatility and CAR will be involved to know the relationship among these specific characteristics and shareholder values.

1.4 Research Questions

- A. Do mergers and acquisitions in Asia-Pacific telecommunication firms significantly impact on the different share return before and after its announcement?
- B. Do mergers and acquisitions in Asia-Pacific telecommunication firms significantly impact on the difference in trade volume before and after its announcement?
- C. Do merger and acquisition in Asia-Pacific telecommunication firms significantly impact on the different in volatility of share prices before and after its announcement?
- D. Do specific firm's factors (age, profitability, leverage) significantly affect to the abnormal returns and volatility surrounding the merger and acquisition announcements?
- E. Do specific firm's factors (age, profitability, leverage) have a significant correlation on CAR and AVAR surrounding the merger and acquisition announcements?

1.5 Research Objectives

- A. To know whether mergers and acquisitions in Asia-Pacific telecommunication firms significantly impact on the different share return before and after its announcement.
- B. To know whether mergers and acquisitions Asia-Pacific telecommunication firms significantly impact on the difference in trade volume before and after its announcement.
- C. To know whether merger and acquisition announcements in Asia-Pacific telecommunication firms significantly impact on the different in volatility of share prices before and after its announcement.
- D. To know whether specific firm's factors (age, profitability, leverage) significantly affect the abnormal returns and volatility surrounding the merger and acquisition announcements.
- E. To know whether specific firm's factors (age, profitability, leverage) have a significant correlation on CAR and AVAR surrounding the merger and acquisition announcements.

1.6 Research Benefits

1.6.1 Theoretical Aspects

- A. Academicians and Researchers
Can be used as a reference regarding analysis of the impact of mergers and acquisitions on shareholder's value.

1.6.2 Practical Aspects

- A. Investors
Knowing the impact of mergers and acquisitions conducted by the firm(s) involved on the shareholders' value which is measured by the share prices and abnormal return after the announcement of mergers and acquisitions

occurred. Moreover, it can be used as a decision making tool to invest in the firm(s) involved.

B. Managers

Can be used as a guideline in decision making process regarding merger and acquisition strategy and its implication on shareholder value creation.

C. Companies

Can be used to see the benefits and the impact of mergers and acquisitions strategy implementation on share prices in order to enhance shareholder value creation. It can be determined by looking at stock price response to mergers and acquisitions that have been conducted by the firm(s) involved.

1.7 Research Scope

1.7.1 Research Location and Objects

The object of this research is 14 telecommunications companies as bidders around Asia-Pacific countries listed in Asia-Pacific stock markets which have a clear information of conducting merger and acquisition between the years 2011-2014.

1.7.2 Research Period

The period of this research is approximately 4 months, which is from August 2016 to November 2016

1.8 Final Project Systematics

CHAPTER 1: Introduction

Chapter 1 serves as general and concise description of the research, which includes research overview, research background, research questions, research objectives, research benefits and final project systematics.

CHAPTER 2: Theoretical Review and Research Scope

This chapter summarizes all valid and scientifically-tested theories, published researches regarding the topic or the problem, a set of reasoning used to describe the research problems that finally form theoretical framework leading to a conclusion, research hypothesis and scope.

CHAPTER 3: Research Method

In general, this chapter underlines the approach, method, and technique used to gather and analyze data to answer or to explain research problem. It presents type of research, operational variable, research stages, population and sample, data collection, type of data, technique of data analysis and hypothesis testing.

CHAPTER 4: Research Results and Discussions

The statistical testing and data interpretation are included in this chapter. Moreover, the resulting problem identification will be further examined.

CHAPTER 5: Conclusion and Suggestion

The result of research findings is concluded in this chapter. Additionally, suggestions are given for the next study related to this research.