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A Study on the Impact of Target Company Equity Structure on Cross-border Mergers and Acquisitions of Enterprises

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Abstract: *As one of the core elements of corporate governance, the shareholding structure of the target company has a profound impact on the performance and integration effect of M&A. In order to reveal the influence mechanism of equity structure on cross-border M&A performance, a study on the impact of target company's equity structure on corporate cross-border M&A is proposed. Combined with managerialism theory, the relationship between managerial compensation and firm size is analyzed. This paper selects Chinese manufacturing cross-border M&A data from 2005-2019 for empirical analysis to explore the impact of equity structure on cross-border M&A performance, and introduces the internal control index as a mediator variable, which helps to analyze the mechanism of the impact of equity structure on cross-border M&A performance in a more comprehensive way. Comprehensive performance evaluation indexes are constructed through factor analysis, descriptive statistics and correlation analysis are conducted based on sample data, and then multiple regression models are established to verify the relationship between equity structure, internal control and cross-border M&A performance. Based on the analysis results, corresponding countermeasure suggestions are also put forward, including improving the supervision of the securities market, gradually reducing the proportion of shares held by the first largest shareholder of the enterprise, and accelerating the reform of state-owned shares, aiming to provide powerful support for Chinese enterprises to make scientific decisions and improve the success rate of M&A.*

Keywords: *equity structure; corporate cross-border mergers and acquisitions; M&A success; impact analysis*

1. Introduction

In recent years, Chinese enterprises have been engaged in frequent cross-border M&A activities in a wide range of fields, from energy and minerals to technology and Internet, and from manufacturing to services, covering almost all major industries. However, during the M&A process, Chinese companies also face many challenges, such as cultural differences, legal barriers, and market access restrictions. Among them, the equity structure of the target company, as an important consideration in M&A transactions, is directly related to the distribution of control, resource integration, and synergies after M&A. Therefore, an in-depth study of the target company's equity structure by systematically sorting out and analyzing the influence mechanism of the target company's equity structure on cross-border M&A can enrich and improve the theory of cross-border M&A, and provide new perspectives and ideas for the research in related fields. At the same time, this study also helps to reveal the performance differences of cross-border M&A under different equity structures, and provides theoretical support for academics and practical circles[1]. The impact on cross-border M&A is of great significance in guiding Chinese enterprises to make scientific decisions and improve the success rate of M&A. For Chinese enterprises embarking on cross-border mergers and acquisitions (M&A), the present research serves as a pivotal tool for enhancing their capability to scientifically assess the equity frameworks of prospective targets. It equips them with the knowledge necessary to devise well-conceived M&A strategies and integration blueprints, thereby minimizing transactional hazards and significantly augmenting the likelihood of successful integrations[2]. Furthermore, this comprehensive study offers invaluable insights to the Chinese government, informing the formulation of pertinent policies aimed at bolstering Chinese firms' competitive edge in the global arena. Scholarly pursuits, both domestically and internationally, have delved deeply into the intricacies of cross-border M&A and the myriad factors that shape their outcomes. These endeavors have not only broadened our understanding of the

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complexities involved but also laid a solid foundation for future endeavors in optimizing the process and enhancing its overall success rates[3]. In essence, this body of work represents a collective endeavor to unlock the full potential of Chinese enterprises in navigating the challenging yet rewarding landscape of international mergers and acquisitions. In terms of shareholding structure, existing studies mainly focus on the impact of factors such as shareholding concentration, nature of shareholders, and executive shareholding on firm performance. However, most of these studies focus on the domestic M&A market, and there are relatively few studies on the impact of target company's equity structure in cross-border M&A. In addition, most of the existing studies adopt case analysis or regression analysis in their methodology, lacking systematic empirical tests and cross-cultural comparative studies. Drawing upon the existing research corpus, the current study endeavors to delve deeper into the intricate relationship between the equity structure of target firms and their impact on cross-border mergers and acquisitions (M&A), adopting a fresh perspective and innovative methodology. This approach aims to uncover novel insights and expand the boundaries of our comprehension in this domain[4]. By adopting a unique analytical lens, we seek to contribute to the ongoing dialogue and enrich the theoretical framework surrounding the intricacies of cross-border M&A transactions. This study starts from the perspective of target company's equity structure and explores its impact on cross-border M&A, which fills the gap of existing research in this field. At the same time, this study also combines the actual situation of Chinese enterprises and the special characteristics of cross-border M&A, which makes the conclusions of the study more relevant and practical.

2. Relevant theoretical foundations

Along with the development of modern corporate system, the separation of operation right and ownership right brings a series of agency problems, how to converge the interests of managers and the interests of the company, so that the managers to improve enterprise value, increase the wealth of shareholders as the goal of corporate activities has been an important issue of the academic community to explore. In M&A activities, the principal-agent problem is more prominent[5]. If the management does not aim at enhancing corporate value and shareholder wealth, but instead only takes M&A activities as a shortcut to increase its own wealth, then blind M&A activities will surely bring negative impacts to the enterprise, and how to balance the interests between managers and shareholders is particularly important. Academics have put forward the following managerialism theory and managerial overconfidence two theories for this kind of situation, this paper takes it as the theoretical basis, takes the proportion of managerial shareholding as one of the factors affecting the performance of cross-border M&A, analyzes and explores the impact of managerial shareholding on the performance of cross-border M&A[6].

The managerialism theory mainly examines the relationship between managerial compensation and firm size. Managerialism theory suggests that since managerial compensation has a positive correlation with the size of the firm, there is an incentive for managers to engage in blind expansion of the firm disregarding the true value of M&A activities to the firm[7]. This theory is mainly represented by Muller, who used managerialism to explain the hybrid M&A problem by assuming that managerial compensation is an increasing function of firm size, and that managers have an incentive to ignore the firm's real rate of return on investment and expand the firm's size through M&A, thereby increasing their own income. He assumes that boards of directors use firm size as a criterion for evaluating managerial compensation, and that M&A is a good way to increase firm size, and that cross-border M&A is a powerful way for managers to increase their compensation by expanding the size of the firm due to the larger size of the capital involved[8]. Moreover, through M&A activities, with the continuous expansion of the company's size, managers not only get more compensation and on-the-job rights, but also gain a certain sense of achievement and reputation in society. Therefore, the original mainstream theory has been that M&A is an external mechanism of corporate governance, which can alleviate the principal-agent problem, but Muir and his colleagues believe that management to increase their own compensation for the purpose of M&A will increase the "moral hazard" and deepen the contradiction caused by the agency problem[9]. They also believe that M&A does not solve the agency problem, it is only an inefficient external investment activity of the management of the enterprise, which is a form of agency problem. This theory supports that the higher management shareholding is not conducive to the realization of positive cross-border M&A performance.

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3. Study design

3.1 Research hypothesis

The current scholarly discourse on the performance of cross-border mergers and acquisitions (M&A) spans diverse perspectives, necessitating a range of research methodologies and variable selections. Recognizing the unique contextual backdrop of China and drawing upon the insights from pertinent literature, this paper delves into the nuanced impact of equity structure on the performance of cross-border M&A within the Chinese manufacturing sector, adopting an enterprise-level analysis. To gain a more holistic understanding, we incorporate internal control indices as potential mediators, examining their role in shaping the operational mechanisms and influencing factors of cross-border M&A in Chinese manufacturing enterprises. This approach aims to unravel the complexities and nuances of these transactions, providing a deeper insight into their effectiveness and outcomes[10].

(1) Hypotheses on equity concentration and cross-border M&A performance

Embracing the principal-agent framework, a heightened level of equity concentration serves as a catalyst for majority shareholders to exert robust oversight and support to the management, thereby bolstering the performance outcomes of mergers and acquisitions (M&A). Viewed as a pivotal indicator of corporate governance, equity concentration not only illuminates the distribution of corporate property rights but also enhances managerial proficiency and optimizes the internal organizational architecture of the enterprise. Conversely, a low equity concentration scenario can significantly diminish the enterprise's decision-making efficiency, potentially stunting its growth trajectory and adversely impacting its overall performance. Therefore, equity concentration, as an important corporate governance mechanism, is of great significance to help enterprises better grasp their internal operation mechanism and improve decision-making efficiency and management level. Accordingly, hypothesis H1a is proposed.

H1a: Equity concentration is positively related to firms' cross-border M&A performance.

(2) Hypotheses on equity checks and balances and cross-border M&A performance

The degree of equity checks and balances is an important consideration in corporate mergers and acquisitions. If the degree of equity checks and balances is too high, it may lead to too much dispersion of equity in the enterprise and a decrease in decision-making efficiency, which in turn affects the efficiency of the enterprise. The interest convergence hypothesis supports that the higher the equity concentration, the more the interests of the controlling major shareholder and the development of the enterprise converge. If the equity checks and balances are too high, the rights and interests of the majority shareholder will be too much constraints, and the control and operation rights it possesses will be weakened accordingly, making it difficult to effectively exert the incentive effect of the majority shareholder. This will also make the majority shareholders less active in the development of the enterprise, and even trigger the backlash of the majority shareholders, which in turn affects the development and performance of the enterprise. Accordingly, hypothesis H1b is proposed.

H1b:Equity checks and balances are negatively related to firms' cross-border M&A performance.

3.2 Data sources and sample selection

The present study empirically delves into the intricacies of how equity structure influences the performance of cross-border mergers and acquisitions (M&A), drawing upon the research scope and accessibility of pertinent variables[11]. To achieve this, we have meticulously curated a dataset comprising 415 cross-border M&A transactions within the manufacturing sector, spanning the years 2005 to 2019, sourced from reputable databases such as WIND and CSMAR. This strategic selection of events aligns seamlessly with the existing scholarly corpus while also catering to the unique research characteristics and objectives of this paper, ensuring a comprehensive and nuanced analysis.

The sample data were processed as follows.

(1)M&A occurs when China's manufacturing industry is the main M&A party

(2) The acquired enterprise is a foreign enterprise located abroad

(3) M&A events have been successfully completed

(4) Excluding ST, *ST and other companies with clearly abnormal data

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(5) Excluding sample firms with severe missing observations

(6) Exclusion of enterprises whose place of incorporation is in tax havens such as the Cayman Islands, Bermuda, etc.

In this paper, the Cathay Pacific (CSMAR) database and Wind library are used for data collection and supplementation, and key variables are subjected to a 1 percent reduction in the upper and lower tails to eliminate the effect of potential extreme values. Data organization and empirical analysis are mainly completed using Excel and Stata.

3.3 Selection of variables

(1) Explained Variables

In order to comprehensively measure the performance of Chinese manufacturing enterprises before and after cross-border mergers and acquisitions, this paper comprehensively applies the four comprehensive financial performance indicators obtained from the factor analysis method above, and combines a large amount of literature as well as the analysis and organization of the above decision to make a difference in the comprehensive performance of enterprises before and after mergers and acquisitions, and to arrive at the difference in the comprehensive performance of the enterprise as an explanatory variable for the empirical part. If LMP is greater than 0, it means that M&A activities can make the long-term performance of enterprises better, and vice versa. The formula is shown in the following table 1.

Table 1: Symbols of long-term M&A performance and the formula for calculating them

explanatory variable	Symbolic representation	Formula
Long-term merger and acquisition performance (LMP)	F_0	$f_0 - f_{-1}$
	F_1	$f_1 - f_{-1}$
	F_2	$f_2 - f_{-1}$

(Note: F0, F1, and F2 respectively represent the comprehensive financial performance indicators in the 0th, 1st, and 2nd year after the merger. F-1 represents the comprehensive financial performance indicator value of the year before the merger. LMP (Long term M&A Performance) is measured by calculating the difference in performance between different time periods after the merger (such as year 0, year 1, year 2) and the year before the merger.)

(2) Mediating variables

This paper reflects the level of internal control quality with the help of the standardized Dibble Internal Control Index. The index has certain authority and credibility, and can fairly reflect the level of internal control effectiveness of listed companies in China in a more comprehensive way. The larger the value, the higher the quality of internal control and the higher the effectiveness of internal control, while the smaller the value, the lower the quality of internal control and the lower the effectiveness of internal control.

(3) Explanatory variables

This research employs a dual-faceted approach to quantify equity structure, encompassing both equity concentration and equity checks and balances mechanisms. To assess equity concentration, we employ the metric of the largest shareholder's shareholding ratio within a listed company, providing a clear indication of ownership concentration. Additionally, to evaluate equity checks and balances, we calculate the ratio between the collective shareholding of the second to tenth largest shareholders and the shareholding of the largest shareholder, offering insights into the extent of power distribution and potential counterbalancing forces within the corporate structure.

3.4 Model construction

In order to well analyze the impact data of the shareholding structure of the target company, three benchmark models are constructed, which are as follows:

(1) To detect the effect of equity concentration on cross-border M&A performance, model (1) is constructed.

$$LMP_{i,t+1} = \alpha_0 + \alpha_1 HERF_{i,t-1} + \alpha_2 Controls + \varepsilon_1 \tag{1}$$

Where, $LMP_{i,t+1}$ represents long-term M&A performance, $HERF_{i,t-1}$ represents equity concentration, α represents performance correlation coefficient, and ε_1 represents residual term.

(2) To test the effect of equity checks and balances on cross-border M&A performance, model (2) is constructed.

$$LMP_{i,t+1} = \alpha_0 + \alpha_1 HERF_{i,t-1} + \alpha_2 Controls + \varepsilon_2 \tag{2}$$

(3) To test the effect of equity concentration on the quality of firms' internal control, model (3) is constructed.

$$ICQ_{i,t+1} = \beta_0 + \beta_1 HERF_{i,t-1} + \beta_2 Controls + \varepsilon_3 \tag{3}$$

where $ICQ_{i,t+1}$ represents the quality of internal controls.

Test the impact of equity balance degree on the quality of enterprise internal control, and build a model (4).

$$ICQ_{i,t+1} = \beta_0 + \beta_1 HERF_{i,t-1} + \beta_2 Controls + \varepsilon_4 \tag{4}$$

Where, ε_4 represents the residual term.

According to the intermediary effect, to test whether there is any intermediary effect between internal control quality on ownership structure and cross-border M & A performance, the model is constructed as follows:

$$LMP_{i,t+1} = \kappa_0 + \kappa_1 HERF_{i,t-1} + \kappa_2 ICQ_{i,t+1} + \kappa_3 Controls + \varepsilon_5 \tag{5}$$

$$LMP_{i,t+1} = \kappa_0 + \kappa_1 HERF_{i,t-1} + \kappa_2 ICQ_{i,t+1} + \kappa_3 Controls + \varepsilon_6 \tag{6}$$

Where, κ represents the mediation effect weight parameter, $\varepsilon_5, \varepsilon_6$ representing the residual term.

Based on this, follow-up studies were carried out.

3.5 Analysis of empirical results

(1)Descriptive analysis

Table 2 demonstrates the descriptive statistics of the explanatory variables, explanatory variables and continuous variables in the control variables. The results in the table show that it can be seen that the minimum values of firms' performance are -3.348, -3.003, -3.155, and the maximum values are 4.355, 3.668, 4.246, which indicates that there is a wide variation in the performance of the different firms in the sample aggregate.

Table2: Table of descriptive statistics analysis of total sample variables

VarName	Obs	Mean	SD	Min	Median	Max.
F0	415	-0.022	0.5578	-3.348	0.029	4.355
F1	415	0.017	0.583	-3.003	0.006	3.668
F2	415	0.002	0.586	-3.315	0.001	4.246
HERF	415	0.349	0.15	0.074	0.835	0.891
HERN	415	0.998	0.077	0.028	0.394	4.564
DFL	415	0.384	0.178	0.081	22.05	0.733
ICQ (Internet Explorer)	415	6.498	0.12	5.79	6.507	6.88

Equity concentration is the ratio of the shareholding of the first largest shareholder of the sample firms, its minimum value is 0.074, maximum value is 0.891, and standard deviation is 0.15, which indicates that there is a large difference in the equity concentration of the sample firms. Equity checks and balances is the ratio of the sum of the shareholdings of the second to tenth largest shareholders to the shareholdings of the first largest shareholder, with a minimum value of 0.028, a maximum value of 4.546, and a mean value of 0.998, which suggests that the overall shareholders of the sample enterprises are at a relatively high level of checks and balances. The mean value of the quality of internal control is 6.498, which indicates that the quality of internal control of the sample firms as a whole is relatively good.

Then analyze the descriptive statistics results of each control variable, the indicator value of M&A scale changes a little bit more relative to other control variables, its maximum value is 25.246, its indicator is much higher than 1, the standard deviation of this indicator is 1.2, and the standard deviation of other control variables is less than 1. It can be seen that, compared to the M&A scale, the indicator value of other control variables fluctuates a little bit less, and the scale of each enterprise difference is larger, but the overall scale level is higher. Regarding the mode of payment, payment in cash is 1, otherwise it is 0. From the standard deviation, it can be seen that nowadays when enterprises carry out mergers and acquisitions, cash transactions are dominated[12]. The nature of property rights for state-owned enterprises is 1, otherwise it is 0, which verifies that the status quo of cross-border mergers and acquisitions in China, as described earlier, is based on the gradual prominence of the power of private enterprises. The mean and median of the rest of the control variables are relatively similar, the standard deviation is not large, and the data are basically symmetrically distributed.

(2) Regression analysis

First, the regression analysis was conducted on the influence of equity concentration and internal control on the performance of cross-border mergers and acquisitions, and the results are shown in Table 3.

Table 3: Regression results of the impact of equity concentration degree and internal control on the performance of cross-border mergers and acquisitions

	F_0	F_1	F_2
HERF	0.327***	0.617***	0.636***
DFL	1.646***	1.379***	0.351
lnAcquire	-0.0669**	-0.0583*	-0.0889***
Age	-0.00546	0.0131	0.0989
MER	-2.249***	-0.836	-1.239
Cash	0.171***	0.179***	0.158***
Ownership	-0.162***	-0.0382	0.0871
InSale	-0.0874	0.369	-0.0348
VC	0.0648	-0.0153	0.0522
Culture	0.00548	0.00554*	0.0257

Note: *, * * and * * * are significant at 10%, 5% and 1%, respectively.

As shown in Table 3, equity concentration shows a positive correlation with the three explanatory variables (F0, F1, F2) at the 1% level, and its driving effect on cross-border M&A performance becomes increasingly significant over time. The logic behind it is that the increase in equity concentration can stimulate major shareholders to supervise the management more closely, thereby promoting the improvement of managers' abilities and ultimately enhancing the overall performance of cross-border mergers and acquisitions. As for controlling variables, the financial leverage ratio has a significant positive impact on cross-border M&A performance in the short term, but in the long term, this relationship is not significant. On the contrary, cash holdings show a significant positive correlation with merger and acquisition performance in both the short and long term, indicating that sufficient cash reserves are a key factor driving performance improvement for enterprises. The effect of transaction size shows a reverse trend, which contradicts the positive effect mentioned above. In addition, cultural distance has become a catalyst for improving cross-border M&A performance, revealing the potential positive effects of cultural diversity, which may promote innovation and cooperation, thereby enhancing overall performance after M&A.

Then, the influence of equity balance and internal control on cross-border merger and acquisition performance is analyzed accordingly, and the results are shown in Table 4.

As shown in Table 4, there is a significant negative correlation between the degree of equity balance and the dependent variable, manifested by all negative regression coefficients. This phenomenon indicates that with the strengthening of equity balance, the equity structure tends to be decentralized, which in turn leads to the delay and efficiency decline of the company's decision-making process, ultimately exerting a significant inhibitory effect on cross-border M&A performance. In the consideration of controlling variables, both financial leverage ratio and cash holdings show a significant positive driving effect on cross-border M&A performance at the 1% level, indicating that these two factors are key factors in promoting post M&A performance growth. However, the scale of cross-border mergers and acquisitions shows a negative correlation with M&A performance, that is, the expansion of M&A scale has not brought the expected performance improvement, but may have led to a decline in performance due to factors such as increased management complexity and difficulty in resource integration.

Table 4: Regression results of the impact of equity balance and internal control on the performance of cross-border mergers and acquisitions

	F_0	F_1	F_2
HERF	0.472**	0.712***	0.727*
DFL	1.642***	-0.0428*	0.274
lnAcquire	-0.0653**	1.324***	-0.0840***
Age	-0.0285	-0.0535*	0.0567
MER	-2.324***	-0.939	-1.256*
Cash	0.172***	0.187***	0.166***
Ownership	-0.159***	-0.0655	0.0724
InSale	-0.0818	0.351	-0.0452
VC	0.0634	0.0242	0.0455
Culture	0.000581	0.0456	0.0183

Note: *, * * and * * * are significant at 10%, 5% and 1%, respectively.

4. Recommendations for countermeasures

4.1 Improvement of securities market regulation

The holders of outstanding shares are the general public, who invest mainly for short-term benefits, and for whom cross-border mergers and acquisitions may be good or bad news, which may have both positive and negative effects. When the market receives the news of cross-border mergers and acquisitions, the larger the proportion of outstanding shares will amplify its effect, causing the short-term abnormal rate of return to increase the cumulative amount. Since the implementation of the equity separation reform in China, more and more non-circulating shares have entered the market, signaling that China will gradually enter the era of "full circulation" of shares[13]. However, the increase in the number of outstanding shares also makes the stock price start to fluctuate abnormally after the announcement of cross-border mergers and acquisitions, and there may be speculators who take advantage of the opportunity to seize the benefits, and achieve the purpose of quickly looting wealth through the manipulation of the stock price. The listing of non-circulating shares will be carried out in an orderly manner. In the process of orderly promoting the listing of non-circulating shares, attention should also be paid to strengthening the supervision of the securities market, closely monitoring the merger and acquisition activities of merging and acquiring enterprises, and doing a good job in the suspension and resumption of trading on the relevant days, so as to prevent the emergence of malicious speculation in the stock market.

4.2 Gradually reduce the proportion of shares held by the first largest shareholder of the enterprise

The proportion of shares held by the largest shareholder is too large, but also cause decision-making dictatorship, reduce management efficiency, and is not conducive to the integration of cross-border mergers and acquisitions. The gradual reduction of the proportion of shares held by the first largest shareholder is conducive to weakening the power of the first largest shareholder due to its excessive shareholding, allowing more small and medium shareholders to participate in corporate decision-making, and is conducive to the realization of a diversified and rationalized corporate shareholding structure. In addition, we should strengthen the protection of the interests of small and medium-sized shareholders in the articles of association and policies and regulations[14]. The proportion of shares held by the first largest shareholder is too large, which makes it use absolute power to infringe on the interests of small and medium-sized shareholders. With the reduction of its shareholding, small and medium-sized shareholders have a certain right to speak in the enterprise decision-making and the ability to protect their own interests. The introduction of provisions to protect the interests of small and medium-sized shareholders in the articles of association and relevant policies and regulations will enable them to follow the rules and regulations, and obtain stronger protection of their interests.

4.3 Accelerating State-owned stock reform

Due to the special characteristics of China's national conditions, state-owned shares dominate in most of the enterprises, and enterprises whose largest shareholders are state-owned shares are prone to the phenomenon of absenteeism of managers, which makes the management of the enterprise inefficient. At the same time, the state-owned shares dominant enterprises in the eyes of Western enterprises with a political color, is not conducive to the successful implementation of cross-border M&A and the realization of the long-term performance of M&A[15]. With the establishment of China's market economic system and the successful accession to the WTO, China's government and enterprises have realized that if they do not carry out the reform of state-owned stocks and solve the problems of chaotic pricing of assets, distorted stock prices, inefficient management and ineffective supervision brought about by state-owned stock dominance, China's enterprises and even the whole economy will be seriously affected. Therefore, the promulgation of relevant policies and regulations only for the state-owned stock reduction provides legal support, how to speed up in practice to promote the state-owned stock reduction is the real difficulty.

This paper does not support the use of open market trading as an approach to the reduction and transfer of state-owned shares. Since institutional investors have professional knowledge and good management ability, and in cross-border mergers and acquisitions (M&A), as non-state-owned shares, they show a positive impact on the long-term performance of enterprises in cross-border M&A. Therefore, this paper believes that the non-public agreement transfer with institutional investors is more suitable for China's current national conditions. Therefore, to accelerate the reform of state-owned shares, we should play the leading role of the government and focus on cultivating capable institutional investors.

5. Conclusion

The study focuses on multiple dimensions of equity structure, including equity concentration, shareholder type, management shareholding, etc. Through a multi-dimensional and multi-perspective analysis, it comprehensively analyzes how these factors independently or interactively play a role in the whole process of cross-border M&A. This paper finds that a reasonable equity structure can reduce information asymmetry and agency costs in the M&A process, promote effective communication and negotiation between the M&A parties, and lay a solid foundation for smooth integration after the M&A.

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