Corporate Governance Effects on Risk Management and Shareholder Wealth: The Case of Mergers and Acquisitions

A Thesis Submitted in fulfilment of the requirement for the degree of Doctor of Philosophy (Ph.D.)

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To my family

Certificate of Original Authorship

I, Yang Zhang, declare that this thesis is submitted in fulfillment of the requirements for the award of Doctor of Philosophy, in the Business School at the University of Technology Sydney. This thesis is wholly my own work unless otherwise reference or acknowledged. In addition, I certify that all information sources and literature used are indicated in the thesis. I also declare that this document has not been submitted for qualifications at any other academic institution. This research is supported by the Australian Government Research Training Program.

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Abstract

This dissertation contains three empirical research projects investigating the relationship between corporate governance and the performance of mergers and acquisitions (M&As) at the domestic and international levels. Each of the three stand-alone chapters provides a different perspective on corporate governance and its effects on risk management and shareholder wealth in M&A transactions. Within this context, this thesis makes a substantial original contribution to advancing the existing knowledge on measuring, documenting and determining the effects of corporate governance on M&A corporate investment decisions.

The first project in Chapter 2 focuses on the role of corporate governance in improving corporate credit risk in cross-border M&As. Using a large global sample, this chapter finds that an acquirer's credit risk is reduced after buying target companies from countries with stronger creditor or shareholder protection. This result supports the hypothesis that firms can improve governance quality by investing in countries with better regulatory standards. However, corporate credit risk does not deteriorate for acquirers when the takeover target resides in a country with weaker regulatory governance, as managerial behaviour is still constrained by the stricter home regulatory environment. The asymmetric effect of corporate governance on credit risk is robust to the asset quality of the target firm and is more pronounced when it involves a publicly listed target company. The findings of this chapter shed light on a governance arbitrage strategy through which acquirers could manage credit risk in cross-border M&As.

Chapter 3 contributes to the ongoing debate about the effects of corporate social responsibility (CSR), another dimension of corporate governance, on shareholders' wealth. It reveals that the market have different reactions to a firm's socially responsible and irresponsible CSR behaviours. There is no evidence that the stock market rewards socially responsible acquirers in the short term. However, this chapter does find strong evidence that the market judges investments by socially irresponsible firms more negatively. The findings are more pronounced for those acquirers who engage in more CSR activities involving the community, employment relations, environmental and human rights issues. These results suggest that, while

firms cannot create shareholder wealth by merely investing in more socially responsible activities, they can achieve this goal by minimising socially irresponsible behaviours.

Chapter 4 further studies the effects of the firms' socially controversial behaviours on M&A performance. This chapter finds that acquirers identified as "sin" firms (i.e. firms have business involved with tobacco, firearms, alcohol, nuclear power, military and gambling) have significantly higher M&As announcement abnormal stock returns. This result supports the hypothesis that the elevated scrutiny and litigation risk faced by sin acquirers will force managers to produce high-quality M&A decisions, which is consequently reflected in shareholder returns. High-quality financial reporting released by sin companies also reduces information asymmetry, improving shareholders' ability to monitor managerial investment activities and enhancing M&A efficiency. This chapter also reveals that sin acquirers are more likely to substitute stock with cash as the method of M&A payment, as the shares of firms with a controversial business are not well accepted as the currency. It also takes longer for sin acquirers to complete M&A deals, due to the social norm conflicts and difficulties in the post-deal integration. This chapter also provides firm-level evidence about sin stock neglect-effects.

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