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Comment Kaoru Hosono

Using merger and acquisition (M&A) events involving listed companies in China during the 2004 to 2005 period, the author found the following facts:

1. The cumulative abnormal return (CAR) of the M&A firms was significantly negative in 2004, while it was significantly positive in 2005.
2. In 2004, M&A activities initiated by state-owned companies had negative returns, while those done by privately owned companies had positive returns. In 2005, both types of companies had positive returns from M&As.
3. In 2005, the CARs of acquiring and target firms were both significantly positive, though small.
4. For the companies involved in 2005 M&A events, return on assets (ROA) and other financial conditions showed a decline in the year of M&A, but recovered in the following year. On the other hand, leverage increased after M&A.

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To my knowledge, this is the first paper that has ever analyzed M&As implemented by Chinese firms. In general, event studies using abnormal stock returns have the merit of using forward-looking measures but require assumptions of stock markets' efficiency. Accounting studies using financial statements have the merit of using credible (audited) statements but have the drawbacks of backward-looking properties. Given these strengths and weaknesses of the two approaches, it is good to do both, as the author does in this chapter. In addition, we can check whether stock market reactions are consistent with the following financial performances.

I have several comments that I expect to improve this chapter.

First, background information concerning M&As in China may be useful to readers outside China. In particular, information on the types of M&As that are most popular in China would be useful: mergers versus tender offers, focused versus diversified (like conglomerates), paying with stock versus cash, domestic versus cross-border. Experiences of the United States show that tender offers, focused M&As, and paying with cash are more likely to create values (Bruner 2002). In Japan, out-in cross-border mergers are found to be more likely to improve productivity (Fukao et al. 2006). Information on regulations and restrictions imposed on M&As would also be useful to understand the results.

Second, analyses of accounting indicators can be improved in several ways. Most important, the author does not control for macroeconomic or industrial shocks to the profitability and other financial conditions. It might be better to subtract off the industrial (or market) average from the financial ratios of the consolidating firms. In addition, the author looks at the simple average of merging firms without taking into consideration the differences in sizes of acquiring and target firms. It might be better to use weighted average of acquirers and targets in the premerger period. Finally, the author shows only the average values of accounting ratios over time. It would be useful to test statistically whether postmerger accounting ratios change significantly as compared with the premerger values.

Third, the author can elaborate why the stock price responses to M&A announcements are small in China relative to the U.S. stock market responses. The U.S. evidences show that target shareholders receive average abnormal returns in the 20 to 30 percent range, while the estimates of bidder shareholders' returns are negligible or mixed (Bruner 2002). On the other hand, this chapter shows that the CARs for acquiring firms and target firms were 1.68 percent and 2.03 percent, respectively. Why is the CAR for target firms so small and that for acquiring firms significant in China? The differences of the types of M&As, regulations on M&As, or the efficiency of stock market between the United States and China may help explain the differences in the CARs.

Fourth, the author can clarify what hypothesis the event study tests in this chapter. Usually, event studies using stock prices test whether events

(e.g., M&As) increase firm value based on the assumption that the stock market is efficient. On the other hand, in this chapter, the author says in the conclusion, "Our results may demonstrate that China's stock market might not have reached the level of efficiency of the more-advanced economies, but its efficiency in assessing the value of M&A activities might have been improved from 2004 to 2005." Does this chapter test whether China's stock market is efficient given that M&As increase economic values?

Finally, the author may want to test formally whether the differences of CARs by ownership structures and by stock market's boom-and-bust periods are statistically significant.

In sum, this chapter tackles a very challenging and important topic that no one else has ever investigated: the stock market responses to M&A announcements in China. Further improvements of analytical methods and the interpretations of the results based on Chinese regulations and practices will make this chapter more valuable to all that are interested in the functioning of emerging markets.

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Comment Julian Wright

Let me first provide some additional context and background to the chapter. The research question addressed by this chapter is quite simply "do mergers create or destroy value?" This is an important question for finance, industrial organization, and antitrust. There is a large literature that has looked at the question using data mainly from the United States but also from some other developed countries. The literature adopts two main approaches. One is to measure the abnormal stock return associated with merger announcements, and the other is to look at the change in accounting earnings following merger announcements.

The consensus from this literature is that the abnormal stock return to acquiring firms is not significantly different from zero, the abnormal stock return to target firms is significantly positive, and that the combined ab-

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