

Reverse Takeovers in Malaysia: Motives, Regulations and Market Reaction*

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Abstract: This study examines reverse takeovers involving KLSE listed companies over the period 1990 until 1995. Fueled by a buoyant stock market and renewed interest in new issues, many companies found reverse takeover a convenient short-cut route to exchange listing that provides an immediate wealth. The study finds that share prices react very strongly and positively to reverse takeover announcements. It is also observed that the Second Board targets are more prone to market overreaction compared to Main Board targets. The evidence that post-regulation takeover targets gain less than the pre-regulation targets tends to indicate a stifling of market freedom as a result of the new regulation.

1. Introduction

When an acquiring company, say company A, buys over shares of a target company, say company B, and accumulates enough shares to have a controlling interest in company B, company A is said to have taken over company B. However, consider a case where, instead of accumulating shares of company B, company A buys assets of company B, and pays for the purchase with its new shares. Company B then becomes a shareholder of company A. If the amount of shares issued to company B is larger than that already issued prior to the asset acquisition (or an amount of shares large enough for Company B to take over control of company A), then company B is deemed to have taken over company A. This is called a reverse takeover, for the final situation is just the reverse of what it appeared to be in the beginning.

The Securities Commission defines a reverse takeover as a situation whereby a listed company acquires other assets or businesses and as a result, there is a change in the control of the listed company through the introduction of a new dominant shareholder or group of shareholders. Reverse takeovers in the Malaysian corporate market date back to the early 1990s when the local stock market began to gain popularity among the investing public, and there was a sudden burst of interest in new listings, fueled by economic recovery from the economic slowdown of the mid-eighties. The KLSE witnessed a tremendous increase in new listings beginning from the year 1990. Almost without exception, new listings in the early and mid-nineties chalked huge initial returns. This has been documented in numerous studies such as those of Yong (1991), Dawson (1994), Shamsher *et al.* (1994), Loughran *et. al.* (1994), and Isa and Ahmad (1996). In fact Loughran reports that initial returns of Malaysian IPOs are the largest among the 25 international markets surveyed. New listings are therefore seen as bringing about immediate increase in wealth to shareholders. In addition it also allows listed companies access to the much improved capital market to raise funds for future expansion.

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2. Motives for Reverse Takeovers

There are two general motives for a reverse takeover. One is to gain access to the capital market by controlling a listed company, and the other is for a short-cut or backdoor to exchange listing. The process involves the purchase of assets owned by the unlisted company for a consideration which is normally settled by an issue of new shares of the listed company to the unlisted company. After the takeover, the unlisted company becomes the major shareholder with a controlling interest in the listed company. The business of the company is now expanded, and normally the business of the unlisted company dominates the business of the listed company. What follows is normally a major reorganisation involving changes in firm's main operations, board of directors and top management. It is not uncommon for the revamped company to take on a new name, and more often than not, the name of the unlisted company.

A backdoor listing, on the other hand, relates to a situation whereby a listed company acquires unlisted assets (or businesses) either by way of cash and/or issue of securities, and as a result, there is a significant change in the business direction of the listed company, towards that of the acquired assets. The change in the business direction could happen due to the disposal of existing core assets of the listed company upon acquisition of the new assets, or when the value of the new assets constitutes more than 50 per cent of the company's total assets on completion of the takeover.

Companies interested in an exchange listing have to fulfill certain listing criteria. The two most important criteria are paid-up capital and profit records requirements. The process of grooming companies for listing may take a long time because it involves major transformation in ownership structure and management practices. Some newly formed companies find reverse takeover a convenient short-cut to listing. Fueled by the desire for immediate wealth creation and sudden transformation into a corporate celebrity of sorts, these aspiring companies seek undervalued and poorly managed listed companies as targets.

Market analysts raise the issue of inadequate rules and regulations governing reverse takeovers that lead to the lack of information accompanying the announcements. This has made valuation of the wealth impact of the takeover difficult. Market observers also contend that the popularity of second board companies as targets of reverse takeover is unhealthy for the capital markets. It has been argued that the Second Board was established to nurture small companies with growth potential so that they may tap the capital market for further expansion. This objective would be defeated if the second board companies become listing vehicles for big unlisted companies.

3. Objectives of the Study

The objectives of the study are to analyse reverse takeovers in Malaysia over the period 1990 to 1995, and to investigate share price reactions to reverse takeover announcements. This study is important for several reasons. First, takeovers, reverse or otherwise, always create excitement in the stock market. Share prices are known to react strongly to news and even rumors on mergers and takeovers. The study would shed light on the nature and magnitude of price reactions to such announcements. This would help regulators to optimise the extent of regulations to ensure market fairness and transparency. Second, the study also provides evidence on whether a reverse takeover results in an increase in value to the listed company. Since one of the main reasons for a reverse takeover is to find a short-cut route to exchange

listing, it is important to know if the event also brings benefits to the shareholders of the target company. Third, since this is an event study, the speed and accuracy of share price reactions to announcements would provide evidence on market efficiency in the semi-strong form.

4. Takeover Regulations

After the establishment of the Securities Commission in 1993, the regulatory structure of corporate acquisitions has been much simplified. A takeover proposal invariably requires the approval of the Securities Commission and also the Foreign Issue Committee (FIC), apart from the approval of the shareholders. Section 179 of the Company Act, 1965, provides for the appointment of a Panel on Takeovers and Mergers (TOP) to administer, supervise and control takeovers and mergers. It is further provided that the Panel may prepare a code containing general principles and rules to be complied with by firms involved in a takeover or merger. This Code called the Code on Takeovers and Mergers came into effect on 1 February, 1987. The Panel currently resides within the Securities Commission.

The Code defines 'takeover' to mean an acquisition of shares in a target company which, when aggregated with shares already held by the acquirer, would give the acquirer the right to exercise more than 33 per cent of the voting rights of that company. Rule 34 of the Code mandates that where a person has acquired shares which carry one-third or more of the voting rights of a company, then the acquirer is obliged to make an offer to the other shareholders of the target company. This offer is termed a general offer, which is somewhat similar to a tender offer in the existing literature.

The Code sets down the procedure to be followed in the event of such general offers. In this regard, Rule 34 has important impacts on takeovers. It increases the costs of the acquisition as well as the uncertainty of success. The Code requires that the acquirer and its financial adviser ensure that sufficient financial resources are available to the acquirer to satisfy possible full acceptance of the general offer. Since a mandatory offer is a costly exercise, it is not uncommon for an acquirer to announce that an acquisition of target shares is conditional on a waiver being granted by TOP from making a mandatory general offer.

In addition to the Securities Commission's approval, the proposal must also be approved by the FIC. The FIC was set up in 1974 to examine, among other things, proposals for acquisition of assets or any interests, mergers and takeovers of companies and businesses in Malaysia in the light of the objectives of the New Economic Policy. In carrying out its functions, the FIC follows the Guidelines for Regulation of Acquisition of Assets, Mergers and Takeovers (1989) published by the Economic Planning Unit of the Prime Minister's Department. The FIC Guidelines require that the proposed merger or takeover should result in a more balanced Malaysian participation in ownership and control and should lead to net economic benefits in relation to matters such as the extent of Malaysian participation. In relation to takeovers, the FIC Guidelines will apply for any proposed takeover of companies which will result in ownership or control passing to foreign interests, and any merger or takeover of any company or business in Malaysia, whether by Malaysian or foreign interests, or any other proposed acquisition of interests exceeding RM5 million in value.

In addition to the above approvals, where new securities are issued by the acquirer or the target company in a takeover or merger, the approval of the Kuala Lumpur Stock Exchange (KLSE) is required for the quotation and listing of the new shares. In addition, depending on the industry in which the participating firms are in, approval of other authorities such as

the Central Bank, the Director General of Insurance, the Ministry of International Trade and Industry, and the Minister of Finance, may be required.

Besides the regulatory bodies, the Company Act 1965, requires the approval of the shareholders of the acquiring company if the acquisition would materially affect the performance or financial position of the company, or if it involves the issuance of new shares, or if it involves acquisition of shares belonging to directors of the acquiring companies. Shareholders' approval is usually sought in an extraordinary general meeting (EGM) called for the specific purpose to seek approval of the proposed acquisition.

5. Specific Regulations on Reverse Takeovers

The first rule issued by the Securities Commission on reverse takeovers took effect on 28 June 1993, aimed at regulating reverse takeovers involving Second Board companies. The main objectives of the regulation was to ensure that Second Board companies are not simply used as a convenient vehicle by companies otherwise unqualified for listing. The rule stipulates that SC's approval must be obtained for any reverse takeovers involving the Second Board companies. Among the conditions of approval are that the unlisted acquiring company must itself have fulfilled the listing criteria set by the KLSE and the Securities Commission, especially in terms of its profit records. These regulations were later expanded to cover the Main Board companies as well, and this took effect on 4 April 1994.

The rules also ensure that assets acquired are of good quality and meet the tract record and viability criteria, and the acquisition is done at fair valuation. In the past, little information on the acquired asset was made known to the public, and this created difficulty for analysts to evaluate the proposal. Hence the rule also contains a requirement for complete disclosure of relevant information on the acquired asset.

However, exemption from Securities Commission's approval can be obtained for cash acquisition of assets provided the following conditions are fulfilled: (i) there is no disposal of existing core asset(s) of the listed company; (ii) there is no intention to refinance the cash acquisitions through the issue of securities within a time period of at least two years from the completion date of the acquisition; and (iii) the listed public company has the ability to sustain any borrowings taken to finance the cash acquisition.

In addition to the above, the following criteria will also apply for reverse takeovers and backdoor listings:

1. *Time criterion*: Reverse takeovers are permitted only for companies that have been admitted to the Main Board or Second Board for a period of at least two years.
2. *Profit record*: If the new assets to be acquired are complementary in nature to the existing assets of the listed company, the new assets should already be income-generating with a satisfactory profit record between one to two years and have good earnings prospects. This condition applies to both boards of listing. If the new assets to be acquired are non-complementary in nature to the existing business of the listed company, the new assets should show reasonable profit record for the past three years with a minimum aggregate after-tax profit of RM15 million and RM6 million for Main and Second Boards respectively.
3. *Profit projections*: The future profit trend of the assets to be acquired should show a steady growth over the projected period to ensure that the assets to be injected are viable and have growth potential, and that the acquisition should not result in a decline in the earnings of the listed company. This condition applies to both boards of listing. In addition, only for

the Second Board companies, the Securities Commission specifies a maximum tolerable margin of earnings dilution of 10 per cent of its par value, or 15 per cent of par value in the case of a properties company.

4. *Shareholding spread* : At least 25 per cent of the issued and paid-up capital of the listed public company after the acquisition should be in the hands of the public.
5. *Profit guarantee or moratorium on disposal of shares*: The seller of the assets to be acquired is required to opt either for (i) a moratorium imposed on the disposal of the shares of the listed company which are issued as consideration for the acquisition, or (ii) a provision of a profit guarantee of 100 per cent of the submitted annual maintainable profits of the new assets for a period of three years beginning from the year of the acquisition. Notwithstanding the option chosen, the Securities Commission reserves the right to impose any one or both of the options where it deems appropriate.

In applying the criteria for reverse takeovers and back-door listings, the Securities Commission may make certain exceptions under the following circumstances:

1. *Rescue cases*: These involve acquisition or restructuring exercises which are undertaken to rescue ailing listed companies. The Securities Commission specifies the following conditions to be used as broad benchmarks in determining whether a company can be classified as a rescue case: (i)The listed company has suffered losses in the past two financial years and is expected to incur further losses; (ii)The going-concern assumption of the listed company is uncertain owing to serious financial problems, thus threatening its very viability and/or existence; (iii) the listed company has been incurring losses and the cumulative effect is that the value of its existing paid-up capital has been reduced by more than 50 per cent.
2. *Privatisation cases*: Privatisation cases acceptable to the Securities Commission are taken as those which involve the transfer of any Government entity or project to the private sector and which have been considered and approved by the Economic Planning Unit (EPU) of the Prime Minister's Department. There should be certainty of benefits and significant enhancement in earnings per share to the listed public company after injection of the privatised entity project.
3. *Other cases*: Exception could also be given to a business which is oligopolistic in nature and which has exceptional potential such that it will provide immediate and strong contributions to the listed public company's profit and cash flow.

The Securities Commission requires that all announcements pertaining to reverse takeovers and back-door listings should be timely and based on full disclosure of relevant information. The announcements should include but are not limited to the following information in addition to those presently required under the listing requirements of the stock exchange: (i) a summary of the key audited financial data of the assets to be acquired for the past five years or since the date of its incorporation if it is less than five years; (ii) financial effects on prospective earnings per share and proforma net tangible assets of the listed company upon completion of the acquisition exercise; and (iii) prospects of the assets to be acquired.

6. Takeover Theories

There are several theories which can explain takeover motivation and why takeovers should bring benefits to parties involved (Weston and Chung 1983; Roll 1987; Copeland and Weston 1988). Two of these theories have gained considerable support. One is the information effect

hypothesis, and the other is the synergistic gains hypothesis.

The information effect hypothesis refers to an upward revaluation of target's share prices due to the dissemination of new information during takeover announcements. There are two arguments for this hypothesis. The passive view says that the upward revaluation of target share prices is only a consequence of undervaluation by the market prior to takeover announcements. For some reason, the true value was never discovered until the target begins to attract market attention in takeover bids. This situation has been labeled by Bradley, Desai and Kim (1983) as the 'sitting on a gold mine' hypothesis. The active view, on the other hand, holds that the target firm's management is inspired to manage the firm more efficiently than before, in view of the real takeover threat. It implicitly assumes that target's management resists takeover, and strives to improve its firm's performance.

The information effect hypothesis is also related to synergistic motives for mergers and takeovers. If the market believes that the acquiring firms possess inside information on target firms, the potential value of the offer would be reflected in both the acquiring as well as the target firms.

The synergistic gains hypothesis of corporate acquisitions implies that the combination of two firms will result in a combined net gain that is more than the sum of the value of the individual firms. The achievement of synergies through corporate acquisitions may be due to several reasons. Synergies may arise from combining differential efficiencies in the acquirer and the target companies. Thus, if the management of the acquiring company is more efficient than the management of the target company, and if after acquisition, the inefficient target is made as efficient as the acquiring company, then overall efficiency has been increased. This would be reflected in a combined net gain. Synergy may also arise if the target company is simply inefficiently managed and therefore not performing up to its potential. If it is taken over, the acquiring firm may be able to manage the inefficient firm's asset better.

Synergies may also arise from economies of scale enjoyed by combining companies. Basically, economies of scale involve indivisibilities such as people, equipment and overheads, which provide increasing returns if spread over a large number of units of output. Known as operating synergies, it assumes that prior to the combination, the firms are operating at levels of activity that fall short of achieving economies of scale. Combining companies can also lead to financial synergies which can be brought about by a lower cost of capital as a result of reduced risk of bankruptcy.

7. Previous Studies

Many empirical studies have been carried out to examine whether acquisitions, takeovers and mergers are gainful exercises to the participating firms. In a comprehensive summary article, Jensen and Ruback (1983) reviewed 13 studies on mergers and acquisitions. These include, among others, Asquith (1983), Asquith, Bruner and Mullins (1983), Bradley, Desai and Kim (1983), Malatesta (1983), and Ruback (1983). They concluded that takeovers and mergers do generate positive gains for the participating firms. Whilst the division of gains between the target and bidders is not equal, on the whole, the authors are satisfied that targets gain and bidders do not appear to lose. Although researchers are generally in agreement that target shareholders do enjoy significant premiums, evidence on the returns to the acquiring firm's shareholders are less certain and sometimes conflicting. Later evidence from Agrawal, Jaffe and Mandelker (1992) who reexamined the issue reveal that acquiring firms suffer significant

losses over a five-year post-merger period.

Bradley, Desai and Kim (1983; 1988) document that successful tender offer increases the combined value of the target and acquiring firms. They also provide empirical evidence that competition among bidders decreases returns to acquirers while it increases returns to targets. They also present evidence that government regulations have no impact on the total synergistic gains created, but have significantly affected their division between the stockholders of target and acquiring firms.

Malatesta (1983) examined price behaviour on two merger event dates, that is, the announcement date and the outcome date. His results show that targets' price reaction to the announcement of a merger was significantly positive, in both pre- and post-announcement periods. For acquiring firms, returns for the pre-announcement period are not significantly different from zero while post-announcement returns are significantly negative. However, at the announcement of the board approval, the cumulative returns for acquiring firms dropped, whilst the acquired firm experienced a price appreciation.

In the local scene, very few empirical studies have been conducted on takeover activities of the public listed companies in Malaysia. Isa and Lim (1993) looked at share price behaviour around acquisition announcement of successful and unsuccessful acquisitions. They found that around the announcement day, targets gain but acquirers neither gain nor lose. However, surprisingly, unsuccessful targets gain while successful targets do not, and similarly unsuccessful acquirers gain and successful acquirers do not. This could be due to the possibility that successful acquisitions are fully anticipated, while the unsuccessful ones are not. Fauzias (1993) and Isa (1994) find that both targets and acquirers gain around the announcement day, and that gains to targets are greater than that for acquirers. In addition Isa (1994) also found that the market prefers cash offers to share exchange offers.

8. Data and Methodology

To obtain data for this study, various financial publications were scanned for reports involving reverse takeovers within the period beginning from 1 January 1990 until 31 March 1995. This process required that the term reverse takeover was clearly mentioned in the report. It is quite possible that a takeover application was considered a reverse takeover by the SC, but if it was not reported as such in the financial press, it would not be included in the sample.

Each reverse takeover was then traced to its first announcement as reported by the *Business Times* daily newspaper. Sometimes, it was necessary to consult company files from the KLSE library to obtain further information, but only after the initial date of the announcement had been determined. It was found that over the period, there were 42 incidents of reverse takeovers reported in the press. Because of our desire to isolate the effect of reverse takeovers on share prices from other influences, the sample had to fulfill a cleansing condition i.e. no major event took place over the period 150 trading days before to 150 days after the announcement. This requirement resulted in the elimination of 12 samples, leaving only 30 reverse takeovers for analysis. Since market data was not available on the (unlisted) acquiring company, this study only analysed price behaviour of the (listed) acquired company.

The period beginning from 1990 marked a significant improvement of stock trading in Malaysia. This has much to do with the introduction of a series of market reforms taken by the KLSE and other regulatory authorities since the late eighties to develop the local market. Since then the number of market participants and trading volume has increased tremendously. There was also an increase in awareness in market research and more professionalism in

portfolio and asset management. These developments have resulted in marked improvement in the reliability of market prices and accordingly in market efficiency. In short, the quality of the market data used in this study is much improved compared to studies using earlier data, and this lends more credibility to the current results.

For this study, stock returns data were obtained from the PACAP database compiled by the University of Rhode Island. For each reverse takeover announcement, daily data were collected for a period of 301 days around the announcement, beginning from 150 days before to 150 days after the announcement day. In calculating security returns, all prices were adjusted for capital changes such as bonus and rights issues. Cash dividends were also included in the returns calculation.

Stock returns are calculated as follows:

$$R_{it} = [(P_{it} + D_{it}) / P_{i,t-1}] - 1.0$$

where R_{it} = return for security i for day t ,

P_{it} and $P_{i,t-1}$ = prices for stock i for days t and $t-1$ respectively, and

D_{it} = cash dividend of stock i distributed on day t .

The study used the market model to obtain abnormal returns to analyse price behaviour around the announcement day. The event window was 101 days around the announcement, beginning from 50 days prior to the announcement to 50 days after. Market model parameters were estimated twice. The first estimation period was from days -150 to -51 to obtain parameters for return adjustment before the announcement day. The second estimation period was from days 51 to 150 to obtain parameters for return adjustment on and after the announcement day. The KLSE Composite Index was used as proxy for market return.

Market model parameters were obtained by running the following regression in the estimation period:

$$R_{it} = \alpha_i + \beta_i R_{mt} + \varepsilon_{it}$$

where R_{it} = returns on stock i for day t ,

R_{mt} = returns on the market index,

α_i and β_i are respectively the intercept and the slope of the market model, and

ε_{it} = is the error term of the regression.

The market returns is calculated as follows:

$$R_{mt} = I_{it} / I_{i,t-1} - 1.0$$

where I_{it} and $I_{i,t-1}$ are the values of the KLSE Composite Index on day t and day $t-1$ respectively.

Abnormal returns were calculated by taking the difference between the actual returns of the stock and its expected returns as predicted by the market model:

$$AR_{it} = R_{it} - (\alpha_i + \beta_i R_{mt})$$

where AR_{it} = abnormal returns for stock i for day t ,
 R_{it} = actual returns for stock i for day t ,
 α_i and β_i are the market model parameters obtained in the estimation period, and
 R_{mt} = returns on the KLSE Composite Index on day t .

For each day, t , within the study window, average abnormal returns (AAR_{it}) were calculated as follows:

$$AAR_t = \Sigma AR_{it} / N$$

T -statistic was used to test the significance of the average abnormal returns. It was calculated as follows:

$$T_{AAR,t} = (AAR_t / S_t) \sqrt{N}$$

where S_t is the standard deviation of the abnormal returns of stocks on day t . It was calculated as follows:

$$S_t = [\Sigma (AR_{it} - AAR_t)^2] / (n-1)$$

To analyse the cumulative effect of the abnormal returns, the cumulative abnormal returns (CAR) were calculated beginning from day 50 prior to the announcement day until day 50 after the announcement day.

9. Empirical Results

9.1 Sample Distribution

The distribution of the sample is shown in Table 1. Our study found no reverse takeover taking place prior to 1992. The earliest reverse takeover announcement was on 28 October, 1992.² This is not at all surprising because it coincided with the time of renewed market interest in new listings. It is also to be expected that most reverse takeovers occurred in the years 1993 and 1994 during which time the local market experienced an abnormal bullish situation. It is also noted that most reverse takeovers occurred in the industrial sector. As noted earlier, given the relatively smaller size of the Second Board companies, they become natural candidates for reverse takeover targets.³

It is also interesting to note that the Second Board companies were popular candidates for reverse takeovers in the earlier period of study i.e. 1992 and 1993, but fell out of favour in 1994 and 1995. This may well have to do with the restrictive regulation enforced by the Securities Commission in the middle of 1993 as mentioned earlier. In fact, the same regula-

² *Malaysian Business*, a local bimonthly business magazine, reported on 1 April 1993 that the first instance of reverse takeover was when an attempt was made to inject Tropicana Golf Club into Second Board Actacorp in 1991. This attempt was aborted. The first reverse takeover approved by the authority, the now defunct Capital Issues Committee was the reverse takeover of Second Board zinc oxide manufacturer Metacorp by highway toll operator Metramac in 1992. This has been considered the precedent that opened the floodgates. Since then the Second Board companies have been subject to frequent news and rumours of reverse takeovers.

Table 1: Distribution of the number of reverse takeovers used in this study, by year and by business sector.

	1992	1993	1994	1995	Total
Second Board	2	5(1)	1(1)	0	8(2)
Consumer products	0	1(1)	2	0	3(1)
Finance	0	1	0(1)	0	1(1)
dustrials 2	3(1)	5(2)	1	11(3)	Mining
0	0	1	0	1	Plantation
0 2(1)	1(3)	0	3(4)	Properties	0 0
1 0	1	Trade and services	0	1	1(1) 0
2(1) TOTAL		4	13(4)	12(8)	1

Note: The number in parentheses denotes the number of announcements that were dropped from the sample due to other important events taking place during the study window.

tion when enforced over the entire listed companies in April 1994, may have spooked all interests in reverse takeovers. Except for one incident, reverse takeovers in 1995 were almost non-existent.

9.2 Price Behaviour for the Whole Sample

Table 2 shows returns analyses for the entire sample of reverse takeovers over the event window of 101 trading days beginning from 50 days before to 50 days after the announcement day. The average abnormal returns (AARs) and the cumulative abnormal returns (CARs) over the period are also shown in Figure 1(a) and Figure 1(b) respectively. The announcement day, day 0, is the day the news on reverse takeover was officially announced and reported to the press. The item normally appears in the press the following day. Although the market could be expected to have learnt of the news on day 0, it only becomes the domain of the public on day 1. Therefore price reactions on days 0 and 1 together could be taken as resulting from the announcement.

Table 2 shows that indeed there exists large abnormal returns on days 0 and 1 of 8.1 per cent and 16.4 per cent respectively. Both are significantly greater from 0 at better than 5 per cent level. These high and significant AARs are clear evidence that the market reacts to reverse takeover announcements in a positive manner. It is also quite common that the stock price of the listed company reaches session limits for both the morning and afternoon sessions, which means that the price would have moved up by a whopping 69 per cent in a single day.⁴ The table also shows that there is also highly significant abnormal returns at 5.6 per cent on day 1. This may well be due to information leaks one day before the official announcement is made to the public.

Figure 1(a) shows the distribution of AARs over a 101-day event window. There are three

³ The Securities Commission subsequently amended the minimum capital requirement for listing to RM40 million and RM20 million for Main and Second Boards respectively, from an earlier criteria of RM20 million and RM5 million. This amendment took effect as of 1 January 1996. In the beginning of 1997, the capital requirement for the Main Board was raised to RM50 million.

Table 2: Average abnormal returns (AR) and cumulative average abnormal returns (CAR) for the total sample ($N=30$) of reverse takeover targets (1992-95)

Day	AR(%)	CAR(%)
-50	0.7484	0.7484
-40	-0.9867	3.1946
-30	-0.3693	5.1861
-20	0.1791	10.856
-19	-0.5562	10.2998
-18	-0.0321	10.2677
-17	0.3673	10.635
-16	1.5494	12.1844
-15	1.1385	13.3229
-14	0.0238	13.3467
-13	0.3094	13.6561
-12	0.0959	13.752
-11	0.9514	14.7034
-10	1.2211	15.9245
-9	3.9173*	19.8418
-8	1.9294	21.7712
-7	0.8622	22.6334
-6	0.0900	22.7234
-5	-0.0395	22.6839
-4	1.7429*	24.4268
-3	1.8886*	26.3154
-2	1.6170	27.9324
-1	5.6230*	33.5554
0	8.1031*	41.6585
1	16.4412*	58.0997
2	0.2805	58.3802
3	0.0278	58.408
4	-0.6681	57.7399
5	0.3593	58.0992
6	-0.357	57.7422
7	0.3958	58.138
8	0.2952	58.4332
9	-0.1085	58.3247
10	0.2561	58.5808
20	-0.5268	58.8132
30	-0.7133	58.0809
40	-1.0680	55.4153
50	0.1064	55.2696

*Significant at 5 per cent level.

interesting observations. First, the time-series dispersion of the AAR is greater in the pre-announcement period compared to the post-announcement period. Second, there also seems to be more positive than negative AARs in the pre-announcement period compared to the post-announcement period. Third, the three AARs around day 0 clearly indicate the positive impact of the reverse takeover announcement.

Figure 1(b) shows the behaviour of the CAR over the event window. It can be seen that

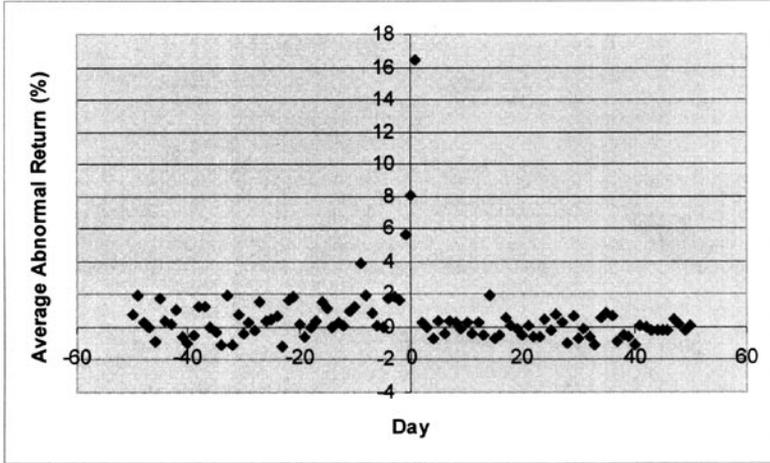


Figure 1(a): Average abnormal returns (AR) for the total sample ($N=30$) of reverse takeover targets (1992-1995).

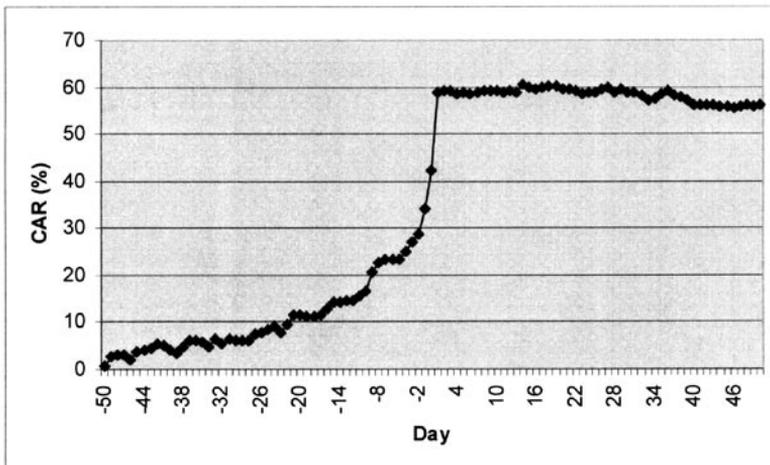


Figure 1(b): Cumulative average abnormal returns (CAR) for the total sample ($N=30$) of reverse takeover targets (1992-1995).

⁴ During this time, the KLSE maintained a session price limit of 30 per cent. If the price moves up 30 per cent in each of the morning and afternoon sessions respectively, the total price increase for the day would be 69 per cent

the CAR shows a steady increase to about 15 per cent over a 40-day period from day 50 to about day 10. Subsequently, it increases at a faster rate on day 2 achieving another 15 per cent. Over the three days of the announcement period, the CAR shoots up by more than 30 per cent, to a level of about 60 per cent. After the announcement, the CAR levels off. This figure clearly confirms the positive impact of a reverse takeover on market prices. In addition, it also indicates, in much clearer terms compared to previous event studies, evidence of market efficiency in the semi-strong form, where price adjustment is accurate and complete on the announcement day.

The price run-ups prior to the announcement could be attributed to two possibilities. First, there is an information leak into the market. Second, it may be due to market anticipation that the company would be subjected to a reverse takeover. This anticipation may be caused by market rumours, which were rampant during the bullish period of 1993 and 1994.

9.3 Main Board versus Second Board Targets

It was contended that Second Board companies are natural targets for reverse takeovers because of their small size. Indeed the number of reverse takeovers involving Second Board companies tends to support this contention. If there is more competition among acquiring companies to seek Second Board targets, then price appreciation of the Second Board would be expected to be higher compared to Main Board targets.

Table 3 compares returns behaviour for reverse takeover targets of Main Board versus Second Board. The AARs of the two subsamples are graphed in Figures 2(a) and 2(b) respectively, and the CARs are graphed in Figure 2(c). As can be seen in the table, abnormal returns on each of the three days around the announcement are large and significant for the Main Board sub-sample. For the Second Board sample, abnormal returns on day 0 and day 1 are significant at the 5 per cent level. Figure 2(a) shows that the behaviour of the AAR for the Main Board is quite similar to that of the entire sample (Figure 1(a)). However, Figure 2(b) shows that the AAR for Second Board tends to have a larger dispersion of abnormal returns both before and after the announcement. This shows that Second Board targets experience greater volatility in their prices and less degree of price efficiency compared to the main board prices.

Figure 2(c) compares the behaviour of the CARs for both subsamples over the event window. The main board CAR shows steady price run-ups beginning from the study period until the announcement day. This may be due to extended discussions and negotiations that take place long before the official announcement. This lengthy process may cause information leak on the impending reverse takeover announcement. Once announced, the price adjustment is complete, and post-announcement CAR is flat which is consistent with a situation of an efficient market. For the Second Board targets, however, it gives the impression that the negotiation process is short and market is taken by surprise. Hence the announcement impact is large on the announcement day. Because it is a surprise announcement, the market tends to overreact, and this is indicated by a moderate decline in the CAR in the post-announcement period.

The conjecture that the Second Board may have higher returns compared to the Main Board was not supported by these results. In fact the results show that the CARs for the Second Board are consistently lower than those of the Main Board. It appears that firm size and competition to take over small companies do not lead to greater gains to target share-holders.

Table 3: Comparison of average abnormal returns (AR) and cumulative average abnormal returns (CAR) for the Main Board and Second Board subsamples of reverse takeover targets (1992-95)

Day	Main Board (N=22)		Second Board (N=8)	
	AR(%)	CAR(%)	AR(%)	CAR
-50	1.6277*	1.6277	-2.015*	-2.015
-40	-0.2347	5.2516	-3.3502*	-0.2334
-30	-0.1158	7.2972	-1.1662	1.5877
-20	0.9294	15.0805	-2.1789*	0.6163
-19	-0.7363	14.3442	0.0101	0.6264
-18	0.4695	14.8137	-1.6086*	-0.9822
-17	0.576	15.3897	-0.2068	-1.189
-16	1.4269	16.8166	1.8864	0.6974
-15	0.8617	17.6783	1.8998	2.5972
-14	0.0547	17.733	0.0611	2.6583
-13	-0.1783	17.5547	1.6508	4.3091
-12	-0.0133	17.5414	0.3964	4.7055
-11	1.6602*	19.2016	-0.9978*	3.7077
-10	1.4845	20.6861	0.497	4.2047
-9	3.9467	24.6328	3.8366*	8.0413
-8	2.0059	26.6387	1.7189	9.7602
-7	1.0758	27.7145	0.2746	10.0348
-6	0.5883	28.3028	-1.2802	8.7546
-5	0.5148	28.8176	-1.5638	7.1908
-4	1.6084	30.426	2.1129	9.3037
-3	1.8349	32.2609	2.0364	11.3401
-2	0.964	33.2249	3.4128	14.7529
-1	7.0425*	40.2674	1.7194	16.4723
0	6.6208*	46.8882	12.1796*	28.6519
1	14.4482*	61.3364	21.9219*	50.5738
2	-0.2287	61.1077	1.6807	52.2545
3	-0.7214	60.3863	2.0879	54.3424
4	-0.8744	59.5119	-0.1007	54.2417
5	-0.4111	59.1008	2.4779	56.7196
6	-0.0587	59.0421	-1.1775	55.5421
7	0.8840	59.9261	-0.9468	54.5953
8	-0.6042	59.3219	2.7685	57.3638
9	1.1019	60.4238	-3.4374*	53.9264
10	0.8834	61.3072	-1.469	52.4574
20	0.0078	64.0083	-1.9969*	45.8367
30	-0.6208	64.2027	-0.9677	42.8307
40	-0.9224	60.8473	-1.4683	42.0614
50	0.0100	61.1084	0.3714	43.3788

*Significant at 5 per cent level.

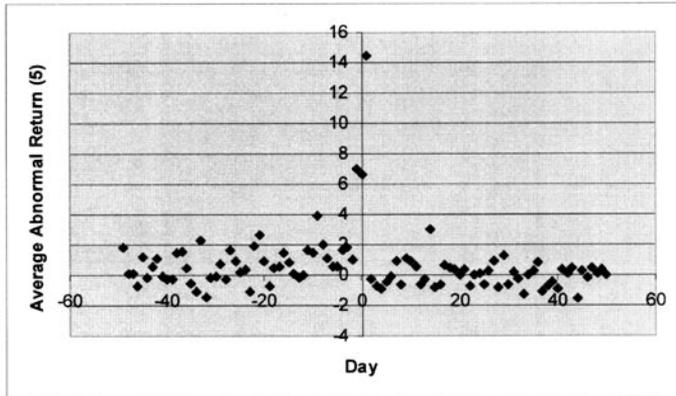


Figure 2(a): Average abnormal returns (AR) around the reverse takeover announcement for Main Board targets (1992-1995) ($N=22$)

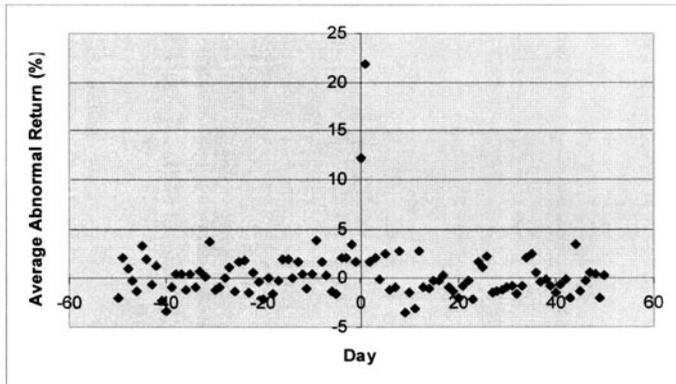


Figure 2(b): Average abnormal returns (AR) around the reverse takeover announcement for Second Board targets, 1992-1995 ($N=8$)

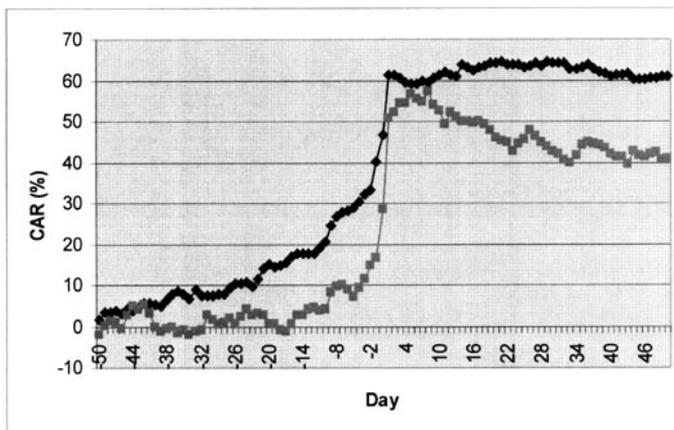


Figure 2(c): Cumulative average abnormal returns (CAR) around the reverse takeover announcement for Main Board and Second Board targets, 1992-1995.

9.4. *The Market Effect of Takeover Regulations*

It was discussed in an earlier section that specific rules on reverse takeovers was enforced by the Securities Commission as of 28 June 1993 for the Second Board companies, and later, on 8 April 1994, the rules were amended to cover the Main Board as well. Since one can argue the pros and cons of enforcing tough regulations, it would be both interesting and useful to regulators to compare market reactions to reverse takeover announcements before and after the enforcement of these regulations.

Table 4 presents returns analyses for reverse takeover announcements before and after the reverse takeover regulations. The CARs are also graphed in Figure 3. Looking at the announcement period of days 1, 0 and 1, it is found that for the pre-regulation sample, only day 1 has a significant AAR of 18.6 per cent. Although days 1 and 0 have large AARs, these are not significant due to large variances. For the post-regulation sample, it is found that the AARs for all the three days are significant. This comparison indicates that the regulation had to some extent reduced the cross-sectional variance of returns of the reverse takeover targets around the announcement days, hence improving price efficiency.

Over the three-day announcement period, the AARs for pre- and post-regulation periods were 31.5 and 28.5 per cent respectively. The CARs on day one for both periods were 66.1 and 51.1 per cent respectively. In addition, Figure 3 show that the CARs for the pre-regulation sample is always greater than the post-regulation sample. The difference tends to widen somewhat towards the end of the 50-day post announcement period. This is evidence of the effectiveness of the regulation.

However, it is hard to explain why the post-regulation CAR is lower than the pre-regulation CAR. If the regulations, among other things, undertake quality control and ensure fair pricing of the injected asset, then one would expect a higher CAR, not lower. The evidence in this section, therefore, tends to point out the negative impact of regulations, which is factored into market prices at the time of the announcement, and also over the 50-day period. However, this market evidence should be taken as tentative, and further studies are necessary before the impact of the regulation could be fairly assessed.

10. Conclusion

Reverse takeovers occur when a listed company issues new shares to acquire other assets or businesses that results in a change in the control of the listed company through the introduction of a new dominant shareholder or group of shareholders. The dominant shareholder then takes control of the listed company, dictating the business direction and management of the company. There are two general motives for a reverse takeover. One is to gain access to the capital market by controlling a listed company, and the other is a for short-cut or back-door to exchange listing.

Because reverse takeovers may result in unfairness in market dealings and may also defeat the objectives of setting up the Second Board, strict rules were enforced. Specifically, the rule stipulates that Securities Commission's approval must be obtained for any reverse take-over involving listed companies. Among the conditions of approval are that the unlisted acquiring company must itself have fulfilled the listing criteria set by the KLSE and the Securities Commission. The rules also ensure that injected assets are of good quality and the acquisition is done at fair valuation. The rules also contain a requirement for complete disclosure of the relevant information on the acquired asset.

Table 4: Comparison of average abnormal returns (AR) and cumulative average abnormal returns (CAR) for the acquired companies before and after enforcement of reverse takeover regulation (1992-95).

Day	Before Regulation		After Regulation	
	AR(%)	CAR(%)	AR(%)	CAR
-50	1.0654	1.0654	0.4087	0.4087
-40	-1.0085	5.1530	-0.9634	2.6896
-30	-0.7022	5.8758	-0.0126	6.0403
-20	0.7097	17.7766	-0.3894	5.0348
-19	0.6382	18.4148	-1.8358*	3.1990
-18	-0.0730	18.3418	0.0117	3.2107
-17	-0.2871	18.0547	1.1151	4.3258
-16	0.9295	18.9842	2.2580*	6.5838
-15	1.4022	20.3864	0.8371	7.4209
-14	-0.4633	19.9231	0.5805	8.0014
-13	0.2367	20.1598	0.3926	8.3940
-12	0.6524	20.8122	-0.5400	7.8540
-11	1.3961	22.2083	0.4432	8.2972
-10	0.3070	22.5153	2.2659	10.5631
-9	2.7008*	25.2161	5.3076	15.8707
-8	2.6051	27.8212	1.1571	17.0278
-7	0.4139	28.2351	1.3745	18.4023
-6	-0.3416	27.8935	0.5832	18.9855
-5	-0.6315	27.2620	0.6371	19.6226
-4	2.9562*	30.2182	0.3563	19.9789
-3	2.2784	32.4966	1.4432	21.4221
-2	2.0541	34.5507	1.1175	22.5396
-1	5.9585*	40.5092	5.2397*	27.7793
0	7.0267*	47.5359	9.3333*	37.1126
1	18.5868*	66.1227	13.9891*	51.1017
2	0.4655	66.5882	0.0690	51.1707
3	1.3199	67.9081	-1.4490	49.7217
4	0.3774	68.2855	-1.8629*	47.8588
5	1.1383	69.4238	-0.5310	47.3278
6	-0.2496	69.1742	-0.4798	46.8480
7	1.8250	70.9992	-1.2376	45.6104
8	0.0192	71.0184	0.6106	46.2210
9	0.5335	71.5519	-0.8423	45.3787
10	0.2160	71.7679	0.3019	45.6806
20	-0.0316	70.9724	-1.0927*	47.0510
30	-0.7416	73.2858	-0.6809	42.8377
40	-1.5566*	71.1788	-0.5095	39.5695
50	0.2487	71.5089	-0.0563	38.8799

*Significant at 5 per cent level.

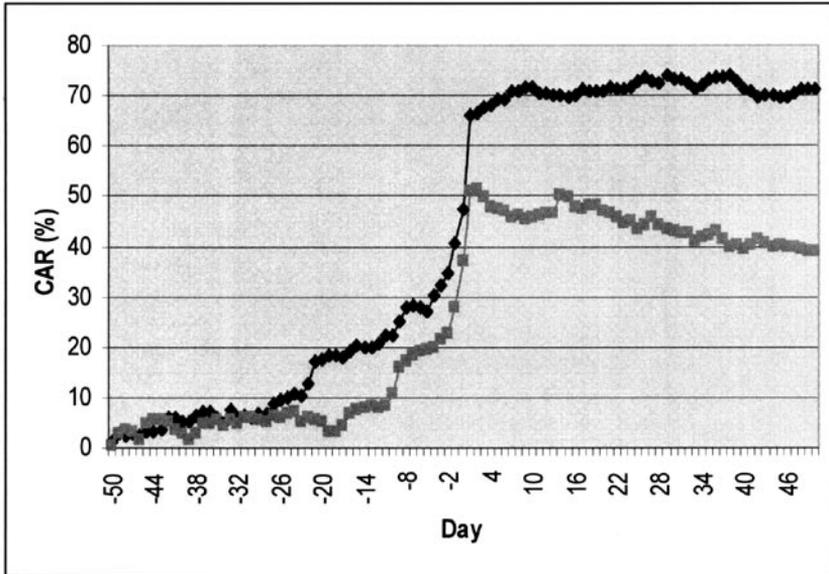


Figure 3: Cumulative average abnormal returns (CAR) around the reverse takeover announcement for targets before and after enforcement of reverse takeover regulation (1992-1995)

It is found that share prices react very strongly and positively to reverse takeover announcements. Share price of the listed target in general appreciates abnormally by about 58 per cent from 50 days before the announcement up to the announcement day. The evidence also strongly supports the notion of an efficient market. It is also observed that the Second Board targets are more prone to market overreaction compared to Main Board targets, possibly due to their small size and hence less media attention during initial negotiations. On the effect of reverse takeover regulations, it is found that it has to some extent reduced price uncertainties, hence volatility. The evidence that post-regulation reverse takeover targets gain less than the pre-regulation targets tends to indicate a stifling of market freedom.

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