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Cross-Border Mergers and Acquisitions in China: A Test of the Free Cash Flow Hypothesis

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This research investigates whether Chinese cross-border investments have positive impact on shareholders wealth and whether the amount of bidders' free cash flow influences the shareholder returns resulted from the acquisitions. The sample is based on 77 top Chinese cross-border investments during the years 2005-2009 with each deal value of minimum US$100 million. The assessments of acquisition abnormal returns are based on the event study methodology (Brown & Warner, 1985). Cross-sectional regression analysis is used to determine the bidding firms factors which significantly affect the returns. Factors are examined using OLS with White's heteroscedasticity-corrected standard errors, since the assumption of homoscedasticity is likely to be violated. The study proves Chinese cross- border acquisitions result in positive abnormal returns which is consistent with synergy hypothesis. The amount of bidders' free cash flow is also found to be marginally but positively associated with shareholders return which is consistent with Myers and Majluf's pecking order hypothesis but unsupportive of Jensen's free cash flow hypothesis.

Keywords: *value creation, cross-border transaction, China, event study, abnormal return, cumulative abnormal return, free cash flow*

Introduction

Chinese companies started conducting cross-border mergers and acquisitions around the 1980s. In 1999, the Chinese government launched "Go Global" policy and since that era, cross-border transactions were actively undertaken and mainly done by large state owned enterprises (Chen & Young, 2010). Originally, it was a small transaction and focus on monopoly industries such as aviation and mineral resources (Liao, 2006).

After the launching of "Go Global" policy and especially after the China involvement in the World Trade Organization (WTO) in 2001, China entered the second wave of cross-border transactions. During these periods, the mergers and acquisitions were characterized by an increase in both scale and speed with a larger number of successful deals and most of deal sizes were more than US$100 million; more private companies were doing the acquisitions; and more diverse countries of target companies not only in Asia but also in North America, Europe, Australia, and Africa. Furthermore, most of these acquisitions were horizontal acquisitions and motivated by the acquisitions of higher technology possessed by target companies (Liao, 2006).

In that second era, Chinese government had a big role in the increasing number of cross-border mergers and acquisitions. It influenced not

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only by its involvement in the management and ownership of the large Chinese corporations but also by its policies which supported government objectives to support domestic companies in the acquisition of advanced technology, brand names, and modern manufacturing know-how (Schuller and Turner, 2005; Wong and Chan, 2003; Zhan, 1995). The policies included the relaxation of capital controls and the offering of special loan programs. They also involved the issuance of a joint circular on the establishment of programs to facilitate overseas investment in natural resources and strategic assets in November 2004 by the National Development and Reform Commission; and the Export–Import Bank of China. The global financial crisis which happened in 2008 also played a major part in this second wave of cross border mergers and acquisitions since Chinese firms considered the prices of these ailing target companies especially in North America and Europe as cheap or at bargain (Chen & Young, 2010).

The purpose of this research is to investigate whether the top Chinese cross-border investments have had a positive impact on the bidding firm shareholders wealth in the years 2005-2009, which is consistent with the synergy hypothesis. The research will also examine whether the amount of free cash flow owned by the acquirers positively affects the shareholders returns resulted from the acquisitions, which is consistent with Myers and Majluf's pecking order hypothesis.

Literature Review

The impact of mergers and acquisitions on the bidders' shareholders wealth can be explained mainly by either synergy hypothesis or managerialism hypothesis. The synergy hypothesis proposes that acquisitions would take place and create value for shareholders if the combined value of the two firms is greater than the sum of the values of the individual firms (Bradley et al., 1988; Seth, 1990a; Weston et al., 2004). The additional value created from the acquisition is then shared between the bidder and the target. Some previous studies report positive returns to acquirers and support the synergy hypothesis (Maquieira et al., 1998; Kohers and Kohers, 2000; Andrade et al. 2001).

The reason why the combined value can be greater than the sum of the individual values is based on the Penrose's firm growth explanation (Penrose, 1959). According to Penrose, each firm tries to seek new products and markets in which a firm can efficiently use both of its tangible and intangible assets to increase its profitability. These assets, which are unique and specialized resources, are considered as "excess" resources. These "excess" resources may increase other firm's profitability but the transfer of these "excess" resources is not free because there will be some market frictions between these firms. If both firms are merged or consolidated, they would be able to eliminate some or all of the frictions and create a synergy.

According to Trautwein, a synergy can be distinguished into three types: financial synergy, operational synergy, and managerial synergy (Trautwein, 1990; Yook, 2003). A financial synergy is created if after the acquisition, the firm would have a lower cost of capital. The lower cost of capital can be achieved by decreasing the amount of systematic risk after the merger, access to cheaper capital market because the firm's size has increased, or the improvement in internal capital market because the capital can be allocated more efficiently. An operational synergy is created if the firm can now operate more efficiently by combining two separate business units or by knowledge transfers (Porter, 1985). Finally, a managerial synergy is created if the firm can lower the cost of managing the combined firm because the bidder's management team possesses superior planning and monitoring abilities that benefit the target's firm performance (Trautwein, 1990).

Furthermore, based on where the target firm is located, a merger or acquisition can broadly be categorized as domestic or cross-border transactions. If a local company acquires another local company, therefore it is considered as a domestic transaction. However, if a local company acquires a foreign company, then it is considered as a cross-border transaction. According to synergy hypothesis, both domestic

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and cross-border transactions might face some market frictions which could be eliminated if the firms are doing some collaboration in the form of mergers or acquisitions. The elimination of these market frictions would eventually result in synergy which increases the value of the firms involved in the mergers.

The foreign direct investment (FDI) theory is aligned with the synergy hypothesis in the context of cross-border merger and acquisitions. Based on the FDI theory, in cross-border transactions, the financial synergy, operational synergy, and managerial synergy would be somewhat different. For instance, firms will invest abroad when growth at home is limited in the presence of trade barriers which restrict exports (Penrose, 1959). Furthermore, tax differentials (Manzon et al., 1994), exchange rate variations (Markides and Ittner, 1994), and international diversifications (Markides and Ittner, 1994; Shimizu et al., 2004) are considered to be associated with synergy creation in cross-border transactions.

Unlike the synergy hypothesis, managerialism hypothesis proposes that merger and acquisition would decrease the bidder's shareholders value. The theory is originally described by Marris (1964) and is also called as the "conflict-of-interest" hypothesis by Seyhun (1990) as well as "agency" hypothesis by Berkovitch and Narayan (1993). The reason why the value is destroyed rather than created is due to the two main reasons: the link between manager's compensation and firm size, and the well integrated capital market.

According to Marris, manager's compensation is frequently tied to the amount of assets under their control. In other words, the bigger the company's size, the higher the manager's individual benefits. Therefore, managers will tend to prioritize growth of assets rather than of profits (Mueller, 1969) and they tend to knowingly overpay in takeovers (Berkovitch and Narayanan, 1993). This is also consistent with the empire building hypothesis (Shleifer and Vishny, 1989).

The second underlying explanation of managerialism is the fact that the capital market is already well integrated nationally and internationally, so the shareholders can do the diversification by themselves. If a firm would like to acquire other firms merely for diversification purposes, the acquisition will actually benefit the managers and harm the shareholders. In other words, the value has been transferred from bidder's shareholders to the managers of acquiring firms. Some previous studies report negative returns to acquirers and support the managerialism hypothesis (Mitchell and Stafford, 2000; Walker, 2000; and Houston et al., 2001).

After determining whether the top Chinese cross-border transactions would support synergy or managerialism hypothesis, this research would also determine the impact of the bidder's free cash flow on the shareholders' return. There are two theories that might explain the relationship between the amounts of bidders' free cash flow prior to acquisition and the shareholders' return after the acquisition. These theories are Jensen's free cash flow theory and Myers and Majluf's pecking order theory.

The Jensen's free cash flow theory proposes that there is a negative association between the bidder's free cash flow and shareholders' return. According to Jensen, free cash flow is "cash flow in excess of that required to fund all projects that have positive net present values when discounted at the relevant cost of capital". This excess cash would motivate the managers to act not in the shareholders interests. In other words, they would tend to invest it at below the cost of capital or wasting it on organization inefficiency. Accordingly, the free cash flow theory predicts that firms with high amount of free cash flow would tend to destroy rather than to create value for the shareholders if they merge with or acquire other companies (Jensen, M.C., 1986). Furthermore, according to Doukas (1995), foreign acquisition announcements by firms with high cash flow and a low q will decrease the bidder's shareholders wealth significantly. In other words, firms without growth opportunities and substantial free cash flow would tend to accept investment projects with negative cash flow or overinvest (Doukas, 1995).

Quite contrary to Jensen's free cash flow theory, Myers and Majluf's pecking order theo-

ry states that there is a positive association between the bidder's free cash flow and shareholders' return. Stockholders are better off *ex ante* – i.e., on average when the firm carries sufficient financial slack to undertake good investment opportunities as they arise (Myers and Majluf, 1984). Undervalued firms lacking financial slack sometimes forgo investments to avoid transferring wealth to new investors (Myers and Majluf, 1984). Therefore high free cash flow firms combined with slack poor target would be expected to generate more positive total returns. Furthermore, returns of bidders with high free cash flow are more positive when the acquisition results in increased use of debt reduced liquid assets and the target is slack poor (Smith and Kim, 1994). In their model, firms with plenty of slack should seek out acquisition targets which have good investment opportunities and limited slack, and about which investors have limited information in order to make both the bidders and target's shareholders better off *ex ante* (Myers and Majluf, 1984).

A previous study of 27 Chinese cross-border mergers and acquisition activities that took place on the Shanghai and Shenzhen stock markets between 2000 and 2004, finds out that acquisitons create value for the Chinese acquiring firms (Agyenim et al., 2008). The primary motives of these acquisitions are increasing market share, promoting diversification, and obtaining foreign advanced technology and other resources (Agyenim et al., 2008). Another recent study also finds that factors which would positively influence the returns of Chinese outward foreign direct investment are the size of the bidder, the advance of target's technological capabilities, and the amount of bidder financial assets (Cui and Jiang, 2010). Therefore the corresponding hypothesis is

H_1: The shareholders of the Chinese acquiring firms engaged in cross-border mergers and acquisitions will earn positive abnormal returns

A study of a set of all UK takeovers of listed domestic companies by UK plcs between January 1984 and December 1992 reveals that Jensen's free cash flow theory does not hold. The higher the amount of free cash flow owned by the bidder, the better the performance of the acquirers (Gregory, 2005; Rau and Vermaelen, 1998). The studies propose that the higher the level of free cash flow that the acquirer has, the better the company manages the financial distress which might happen after the acquisition (Gregory, 2005). The proxies used in this study is similar to those used by Lang, Stulz and Walking (1991). Furthermore, the bidder with enough free cash flow would be able to take valuable acquisition opportunities without having to generate outside financing such as issuing stocks or bonds. This ideal condition would be positively rewarded through favorable market reaction around announcement periods. This research result is compatible with the pecking order theory (Myers, 1984) and empirical findings of Shayam-Sunder and Myers (1999). Therefore the correponding hypothesis is

H_2: There is a positive and significant association between the level of the acquirer's free cash flow and the acquirer's abnormal returns

Research Method

The study sample is based on 77 top Chinese cross-border investments during the years 2005-2009. The acquirer's stock prices, accounting data, and all other information about the acquisitions are available in the Capital IQ. If the acquirer announces more than one transaction in one year, then only the first transaction is included. Furthermore, to limit the research only on big Chinese acquisitions, each transaction should have a deal value of minimum US$100 million to be included the sample.

The assessments of the economic outcomes of the deals are based on the event study methodology (Brown & Warner, 1985). Market is assumed to be reasonably efficient where all currently available information is incorporated in the firm's share price. Therefore the stock prices are the reflection of the new information released. The difference between actual and predictive returns surrounding the announce-

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ment day is defined as the abnormal return. The cumulative abnormal returns during a given time period is then obtained by summing up the abnormal returns for each day during that period.

The Shanghai All A-Share Index and Shenzhen All A-Share Index are used as the proxies for the market portfolio similar with most of Chinese research (Liu and Li, 2000). The index's returns during the estimation period are regressed against the acquirer's stock returns to obtain the acquirer's beta value which will be used to estimate the acquirer's returns around announcement periods. Estimation period is set at 250 to 50 days or about six months prior to the event period (McWilliams & Siegel, 1997). The estimated stock return for a given stock *i* in the event window period is obtained using equation (1):

$$\bar{E}_{it} = \alpha_i + \beta_i R_{mt} \quad (1)$$

$\bar{E}_{it}$ is the predicted stock *i*'s return at time t and α_i, β_i are the regression parameters obtained from the estimation period. R_{mt} is the stock market index *m* daily return observed at time *t*. The stock *i*'s abnormal return at time *t* is then obtained by substracting predicted stock *i*'s return from the actual stock *i*'s return.

$$AR_{it} = R_{it} - \bar{E}_{it} \quad (2)$$

The cumulative abnormal return for stock *i* is the summation of stock *i*'s abnormal return during an event window period (t_0, t_1).

$$CAR_i(t_0, t_1) = \sum_{t0}^{t1} AR_{it} \quad (3)$$

To test the significance of the abnormal returns and cumulative abnormal returns, the ratio of day *t* average abnormal returns to its estimated standard deviation is calculated using equations (4) and (5) (Brown and Warner,1985; Panayides and Gong, 2002).

$$t(\overline{AR_t}) = \overline{AR_t} / \hat{S}(\overline{AR_t}) \quad (4)$$

$$t(\mathrm{CAR}) = \mathrm{CAR}(t_0, t_1) / [\hat{S}(\overline{AR_t}) * \sqrt{(t_0 - t_1)}] \quad (5)$$

Where:

$$\hat{S}(\overline{AR_t}) = \sqrt{(\sum_{t=-250}^{t=-50} (\overline{AR} - \overline{\overline{AR}})^2}$$

and

$$\overline{\overline{AR}} = \frac{1}{200} (\sum_{t=-250}^{t=-50} \overline{AR})$$

To test the second hypothesis, cross-sectional regression analysis is used to determine the bidding firms factors which significantly affect the returns. Specifically, the factors are examined using OLS with White's heteroscedasticity-corrected standard errors, since the assumption of homoscedasticity is likely to be violated. The cumulative abnormal returns are regressed against the acquirer's operating free cash flow (Freund, et.al, 2003), the acquirer's past accounting performance which is represented by its ROE (Kohers, 2001), the type of industry as well as the time of acquisition (Chen and Young, 2010).

The acquirer's operating free cash flow which acts as the independent variable is measured according to the method used by Freund, et.al, (2003), McLaughlin, Safieddine, and Vasudevan (1996), Lang and Litzenberger (1989), and Lehn and Poulsen (1989) and showed in equation (6):

$$FCF = OI - TAX - INTEX - PFDIV - COMDIV \quad (6)$$

Where

OI = the operating income before depreciation
TAX = total taxes
INTEX = Interest expense on debt
PFDIV = Dividends paid to preferred stockholders
COMDIV = Dividends paid to common stockholders

The free cash flow is then divided by the firm's book value of its assets in the year before the merger.

The acquirer's ROE is chosen as the first control variable because based on previous studies, a firm's accounting-based performance significantly and positively affects the market

Table 1. Summary Statistics: Bidders Cumulative Abnormal Returns, Free Cash Flow, Return on Equity, Industry Type, and the Time of Announcement

	CAR (-1,0)	CAR(-1,1)	CAR(-2,2)	CAR(-3,3)	FCF	ROE	IND	TIME
Mean	0.059%	0.467%	0.654%	0.830%	0.064	0.157	0.903	0.556
Median	-0.067%	0.380%	0.613%	1.541%	0.041	0.125	1	1
Maximum	8.634%	11.259%	17.995%	16.422%	0.338	2.718	1	1
Minimum	-14.763%	-14.884%	-16.269%	-25.767%	-0.221	-0.365	0	0
Std. Dev.	3.910%	4.447%	6.583%	8.052%	0.090	0.344	0.298	0.500
Observations	72	72	72	72	72	72	72	72

Table 2. Bidders' Daily Abnormal Returns and Significance Test Statistics for Bidders' Daily Abnormal Returns Around the Announcement Date

Day	AR(%)	t-Statistic
3	0.030%	0.091
2	0.498%	1.515*
1	0.462%	1.405*
0	0.260%	0.790
-1	0.056%	0.169
-2	-0.206%	-0.626
-3	0.026%	0.080

*significant at the 10% level, one-tailed t- test

perception of an acquisition announcement (Kohers, 2001). It means that market will predict an acquisition would be successful if the acquirer has a good accounting-based performance. The second control variable which is a dummy variable is used to differentiate between firms in financial industry and non-financial industry. The last control variable is a time dummy to take into account the effect of global financial recession and the implementation of China's Anti Monopoly Law in 2008.

Equation (7) is the corresponding multivariate regression equation that will be used to test the second hypothesis:

$$CAR_i = \alpha + \beta_1(FCF)_i + \beta_2(ROE)_i + \beta_3(IND)_i + \beta_4(TIME)_i + \varepsilon_i \quad (7)$$

Where

CAR_i = the cummulative abnormal return around the announcement date for firm *i*

FCF_i = the amount of the company *i*'s free cash flow before the acquisition announcement scaled by the company *i*' s book value of assets

ROE_i = the company *i*'s percentage return on equity before the acquisition announcement

IND_i = dummy variable indicating the industry type of the company *i*, taking value of 1 if company *i* is a non-financial industry firm

$TIME_i$ = dummy variable indicating the time the company *i* announces the acquisition, taking the value of 1 if the acquisition announced after the year of 2007

Result and Discussion

The acquirer's abnormal returns are measured during three-day period (three days before and three days after) the announcement day. During these three-day periods, the average abnormal returns of all firms in the sample show positive returns except for the second day before the announcement. On the first and second day after announcement, the average abnormal return is positive at 10% level, one-tailed *t* test.

Similar results are also observed after calculating the acquirer's cumulative abnormal returns during four different event window periods.

H_0: $CAR\ (t_1\text{-}t_2) \leq 0$
H_1: $CAR\ (t_1\text{-}t_2) > 0$

During four different event window periods, the acquirer's mean cumulative abnormal

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Table 3. Bidders' Cumulative Abnormal Returns and Significance Test Statistics for Bidders' Cumulative Abnormal Returns Around the Announcement Date

	CAR (-1,0)	CAR (-1,1)	CAR (-2,2)	CAR (-3,3)
N	77	77	77	77
MEAN	0.308%	0.772%	1.057%	1.111%
MEDIAN	-0.073%	0.448%	0.787%	1.374%
MIN	-14.763%	-14.884%	-16.269%	-25.767%
MAX	16.636%	14.814%	19.495%	17.566%
t-Statistic	0.663	1.356*	1.438*	1.277

*significant at the 10% level, one-tailed t- test

Table 4. The Impact of the Amount of Free Cash Flow on the Bidder's Cumulative Abnormal Return Method: Least Squares with White Heteroskedasticity-Consistent Standard Errors & Covariance

Variable	Coefficient	Std. Error	t-Statistic
Intercept	0.053447	0.018187	2.938702***
FCF	0.107830	0.065495	1.646393*
ROE	0.022990	0.007646	3.006658***
IND	-0.044982	0.015161	-2.966948***
TIME	-0.030326	0.015396	-1.969779**
R-squared	0.148432		
Adjusted R-squared	0.097592		
S.E. of regression	0.062530		
Sum squared resid	0.261973		
Log likelihood	100.019000		
F-statistic	2.919589		
Prob(F-statistic)	0.027448		
Durbin-Watson stat	1.960000		

***, **, and * denote significance at the 1, 5, and 10 percent level respectively in two-tailed test

returns are all positives. The mean cumulative abnormal returns for the buyer during one-day period and two-day period are 0.772% and 1.057% respectively. Although weakly significant, the result shows that market perceives cross-border acquisitions made by top Chinese companies during the period of 2005-2009 is a value creation action for the bidder's shareholders. These positive announcement period stock returns of the acquirers are consistent with the synergy hypothesis.

The association between shareholders returns and the amount of free cash flow after controlling for some key variables is observed from the regression results. Specifically, the firm's cumulative abnormal returns during two-day period are regressed against the bidder's free cash flow scaled by the book value of assets of the buyer, the bidder's ROE, an industry type dummy variable and a time dummy variable. The adjusted *R*-squared of the regression is 9.759% with the *F*-value of 2.920 which is significant at the 5% level.

Contrary from the free cash flow theory(Jensen, M.C., 1986) and supportive of pecking order theory(Myers and Majluf, 1984), the amount of the bidder's free cash flow is positively related to its stock price abnormal return during the announcement period. The coefficient of free cash flow is positive (0.108) and marginally significant at the 10% level. The result shows that during announcement period, the firm's stock abnormal returns rise by 0.108% for every percentage point increase in the free cash flow of the acquirer.

Although weakly significant, our findings are consistent with the latest finding by Gregory (2011) which proves the hypotheses that high free cash flow firms will out-perform low free cash flow firms in a UK market context. In their models, it was discovered that the coefficient of free cash flows in all models are positives although insignificant. Especially in model 2 where the experiment is repeated using FCF-LowQ, a proxy for FCF in low q firms to address the Jensen problem, it turns out that the

coefficients are still positives, although weakly significant, at the 10% level with $t = 1.77$ and $t = 1.92$ in both models. Therefore, contrary to Jensen's theory, there is no hint as well in our sample that the amount of free cash flow is associated with lower abnormal returns. In fact, in our sample, for one percentage point increase in the amount of free cash flow of the Chinese acquirers, the abnormal returns will increase by more than 0.10 percent.

Controlling variables are also statistically significant and showing expected signs. Return on the equity of the buyer in the year before the merger is positively related to the stock price abnormal return during the announcement period at the 1% level. This indicates that market has a tendency to extrapolate bidder's past performance, in this case, the bidder's past profitability into the future (Rau and Vermaelen, 1998). Furthermore, market is more confident about the merger's success if the acquirer has good past performance (Kohers and Kohers, 2000). The cofficient of dummy variable for buyer in a non-financial industry firm is negative and siginificant at 1% level, which indicates that bidders in financial industry seems to perform better than bidders in non-financial industry. Abnormal returns for cross border acquisitions which happened after the year of 2007 are also siginificantly lower than before the year of 2007 at 5% level. This might be related to the negative impact of global financial recession and the implementation of China's Anti Monopoly Law in 2008.

Conclusion

After becoming a member of the World Trade Organization in 2001, China entered the second wave of cross-border mergers and acquisitions. Cross-border transactions in China were not only increasing in numbers but also characterized by an increase in scale. There are larger number of successful deals and most of deal sizes were more than US$100 million. Unlike the first wave of acquisitions which were dominated by state owned enterprises, during the second wave, the more private companies are now doing the acquisitions. Furthermore, the target companies locations are not only in Asia but also in North America, Europe, Australia, and Africa.

The research first objective is to determine whether the second wave of Chinese cross-border mergers and acquisitions adds value to the bidders' shareholders . The empirical study on 77 top Chinese cross-border investments during the years 2005-2009, proves Chinese top cross-border acquisitions result in positive abnormal returns. Therefore, consistent with synergy hypothesis, the market perceives Chinese firms would create synergies by acquiring foreign firms. (Bradley et al., 1988;Seth, 1990a; Weston et al., 2004).

The research second objective is to determine whether the amount of free cash flow possesed by the bidders is associated with the shareholders' return. The empirical study on 77 top Chinese cross-border investments during the years 2005-2009, proves the amount of free cash flow is marginally but positively associated with the abnormal returns around announcement periods. The market perceives that bidders with sufficent financial slack would perform better after acquisition. This is due to the fact that after the acquisition, firms would pose several challenges such as cultural, currency, and other problems inherent in international operations (Shaked et al.,1991; Harris and Ravenscraft, 1991). Therefore, Chinese firms with enough free cash flow would be capable of managing these challenges better than those without enough financial slack. Also, with adequate amount of financial slack, Chinese firms would not have to seek recourse in capital market to finance positive investment opprtunities. This research result is consistent with pecking order theory (Myers and Majluf, 1984) but unsupportive of free cash flow hypothesis (Jensen, M.C., 1986).

Our model is based on previous works following Lang, Stulz and Walking (1991) and Gregory (2005) where the announcement period returns are simply and directly regressed against free cash flow as independent variable. For further research, it might be necessary to explore whether the amount of free cash flow has indirect impact on the bidder's cumulative

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abnormal return since the amount of free cash flow itself might not only have the direct effect but might in fact have some kind of indirect interactions or act as intervening variables which will affect the abnormal announcement returns. It is also advisable for further research to employ other more advanced statistical analysis to test the significance of the impact of free cash flow amount on the bidder's cumulative abnormal returns.

The study has some theoretical contributions and practical implications for academicians, investors, managers and regulators. For academicians, this empirical study on 77 top Chinese cross-border investments during the years 2005-2009 has provided additional evidence that supports synergy hypothesis in cross-border transactions as well as pecking order theory. For investors, this study suggests that shareholders should consider buying shares of Chinese firms which have sufficient amount of free cash flow and active in the cross-border mergers and acquisitions. For managers, before acquiring another company, a firm should have sufficient amount of free cash flow to anticipate future costs that might be incurred after the acquisition process has been completed. Finally, this research should give more insights to the Chinese government to impose regulations that promote cross-border mergers and acquisitions.

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