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Factors Influencing on Operating Performance of Chinese Listed Agricultural Companies Post-M&A

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Abstract

The main objective of this paper was to examine the effects of board independence, board size and leverage on the financial performance of listed Chinese agricultural enterprises after merger and acquisition (M&A). The study addressed the lack of understanding of corporate governance and leverage on the financial performance of post-merger listed Chinese agricultural companies, given the unique challenges and opportunities facing the agricultural sector. This study adopted purposive sample method to select data of 77 M&A events from 2007 to 2019. Data for the two years before and after the acquisition of these 76 listed Chinese agricultural companies were examined. Key variables included board independence, board size, leverage ratio and the change of ROA. Descriptive analysis and linear regression were used to detect the relationship between independent and dependent variables. The results showed that board independence and leverage were associated with improved financial results after mergers and acquisitions. However, board size had no substantial effect on the financial performance of the enterprise after the M&A. This study provided corresponding insights for business leaders, policy makers and investors. The study highlighted the need for strategic governance reforms to achieve sustainable growth, financial stability and long-term value creation in the agricultural sector.

Keywords: Merger and Acquisition, Corporate Governance, Financial Performance, Agricultural Sector

Introduction

Over the past decade, M&A activities by Chinese firms have paralleled China's economic reforms including corporate governance reforms and its integration into the world economy (Boateng, Bi and Brahma, 2017).

China's agricultural sector is one of the best in the world and has contributed greatly to the development of the Chinese economy with full strength and commitment (Gooch and Gale 2018). M&a plays a transformative role in China's agricultural sector and is a key strategy to consolidate resources, improve operational efficiency and secure a competitive position on a global scale. In order to cope with the competitive global environment and promote corporate growth, Chinese agribusinesses are increasingly relying on mergers and acquisitions (M&A). These strategies are essential not only for company restructuring, but also for improving operational efficiency and expanding market reach, thus ensuring the sustainability and growth of the industry. Mergers and acquisitions in the agricultural sector facilitate the strategic integration of resources, enabling companies to optimize allocation and leverage synergies that are critical to maintaining global competitiveness.

However, the success of these mergers and acquisitions largely depends on the governance and financial structure of the companies involved. Factors such as board independence, board size and corporate leverage play a critical role in the outcome of these transactions. For example, independent board directors are critical to ensuring effective oversight and strategic decision-making, which can profoundly influence the success of mergers and acquisitions (Sha, Kang, and Wang, 2020). In addition, the size of the board can influence the decision-making process, with larger boards providing different perspectives and smaller boards potentially enabling more cohesive and rapid decision-making (Lok, Chen, Phua, and Chan, 2021).

The purpose of this paper is to study the factors affecting the business performance of Chinese agricultural listed companies after merger and acquisition. By examining several factors, such as financial variables and corporate governance, and comprehensively understanding what changes they bring to the performance of listed agricultural enterprises that have implemented mergers and acquisitions, this paper aims to provide strategic planning and valuable opinions for listed agricultural enterprises after mergers and acquisitions, so as to achieve positive performance and promote sustainable development of listed agricultural enterprises after mergers and acquisitions.

Statement of the Problem

The increase in M&A activity seems to be very welcome by the companies involved （Inoti, Onyuma, and Muiru, 2014). Du and Boateng(2012) found that past empirical studies mainly focused on frequently studied factors affecting post-acquisition performance, such as firm - and industry-specific variables, and institutional factors. Relatively few studies have examined the impact of internal corporate governance. Supervisory mechanism of board of Directors on M&A performance in the context of emerging markets. However, previous research has shown that low returns for acquirers are due to governance problems caused by managers' insufficient accountability to shareholders. (Gorannova, Dharwadkar and Brandes, 2010).

Objective of the study

The objectives of this research are as follows:

1) To investigate the effect of board directors independence on the financial performance of agriculture companies in China after undergoing merger and acquisition exercise
2) To determine the effect of board size on the financial performance of agriculture companies in China after undergoing merger and acquisition exercise
3) To examine the effect of leverage on the financial performance of agriculture companies

in China after undergoing merger and acquisition exercise.

Research Hypothesis

H1 Board directors' independence has a significant relationship with financial performance of agriculture companies in China after undergoing M&A.

H2 Board size has a significant relationship with financial performance of agriculture companies in China after undergoing M&A.

H3 Leverage has a significant relationship with financial performance of agriculture companies in China after undergoing M&A.

Literature Review

Mergers and Acquisitions

A merger can be defined as the consolidation or merging of two different corporate entities into a single unified entity (mca.gov.in, 2022). In an acquisition, one business buys another, the acquiring business retains its name and identity, and acquires all the assets and liabilities of the acquired business. As a result, the acquired company no longer exists as a separate business entity (Rose, Westerfield, Jaffe, and Jordan, 2007).

Mergers and acquisitions (M&A) are defined as a combination of different companies merging with each other or forming joint ventures to enhance each other's business profits. Mergers and acquisitions can occur between two companies through different types of banking transactions, mergers, acquisitions, mergers, and purchases of assets, respectively. In a rapidly changing global agricultural landscape that requires constant adaptation and strategic restructuring, M&A becomes an important tool for growth and sustainability. Through strategic integration, enterprises can exert synergies, optimize resource allocation, and expand market coverage, which are essential elements to remain competitive in the dynamic agricultural market.

Underlying Theories

Corporate Governance Theory

Corporate governance theory emphasizes the importance of governance structures, such as board independence and board size, in influencing corporate performance. The integration of corporate governance mechanisms can significantly affect the financial performance and strategic success of mergers and acquisitions, especially in China's agricultural sector.

The independence of the board of directors has a positive impact on the financial performance of the company after the merger. Not involved in the daily management of the company , an independent board can provide better oversight and management with less internal conflict of interest. And ultimately more prudent decision-making improves financial performance results. The role of independent directors in supervising management can significantly increase shareholder value in M&A transactions (Singh, 2019).

Board size can also affect financial performance after mergers and acquisitions. When dealing with complex merger transactions, larger boards may offer a variety of perspectives and expertise that can be beneficial; However, a board that is too large can lead to coordination problems and a slower decision-making process. Cox (2006) explained the impact of board size and other governance factors on M&A outcomes, emphasizing the need for a balanced governance structure approach to ensure effective decision-making and successful M&A.

Aktas, Croci, and Simsir (2015), review how various corporate governance mechanisms, including boards and market competition, affect mergers and acquisitions outcomes. Their findings suggest that effective corporate governance can improve the efficiency of the acquisition market, mitigate agency conflicts, and ultimately increase company value.

The higher the independence of the board of directors, will significantly affect the corporate governance quality and financial performance after mergers and acquisitions. The appropriate board size can provide diverse perspectives and expertise while maintaining an effective decision-making process. These insights can guide strategic decisions and policies to enhance the success of M&A and ultimately contribute to the sustainable growth and competitiveness of China's agricultural sector.

Financial Leverage Theory

The financial leverage theory shows that the degree of debt financing plays an important role in affecting the financial performance of the company after merger and acquisition. The study hypothesizes that leverage - defined as the extent to which a company uses debt to finance its operations - has a significant impact on financial performance after merger and acquisition. Increasing leverage can amplify returns, making it an attractive option for companies looking to get the most out of M&A. However, it also poses a risk to financial stability, especially if synergies from a merger or acquisition fall short of expectations. This study aims to explore these dynamics in the context of mergers and acquisitions.

Research on the impact of financial leverage in mergers and acquisitions has shown that high leverage, while it can bring greater financial returns, also increases the risk of financial distress. A comprehensive review of the post-2000 literature on mergers of financial companies by DeYoung, Evanoff, and Molyneux (2009) highlights that bank mergers in North America can improve efficiency, despite mixed results in shareholder wealth creation. European bank mergers, on the other hand, tend to lead to efficiency gains and increased shareholder value. These findings highlight the complex relationship between leverage and financial performance in mergers and acquisitions (DeYoung, Evanoff, and Molyneux, 2009).

Managing leverage is another key aspect. Careful management of debt levels to optimize financial performance while minimizing risk is critical to the success of M&A. A balanced approach is therefore needed to maximize the benefits and mitigate potential negative impacts.

Synergy Theory

Synergy theory shows that two companies can achieve higher efficiency and value after M&A than a single company independently. Under the application of this theory, business efficiency, market power, innovation ability and resource utilization will be improved (Garzella and Fiorentino, 2014).

Enhancing the independence of the board of directors is a practical revelation of synergy theory. Ensuring an appropriate proportion of independent directors improves oversight and reduces conflicts of interest, thereby improving decision-making and financial performance. Moreover, optimizing board size is essential for effective governance. The optimal board size provides diverse perspectives and expertise while maintaining an effective decision-making process. Careful management of leverage is also critical to the success of mergers and acquisitions. Optimizing debt levels can improve financial performance while minimizing risk.

Firm size is another important factor. Leveraging the resources and capabilities of large companies helps achieve economies of scale and efficient integration, thereby improving the overall success rate of mergers and acquisitions. Finally, maximizing synergies through strategic resource allocation and integration process can realize all potential benefits of M&A. The practical application of these synergistic theories can help business leaders, policymakers and investors make more informed decisions, thereby facilitating successful mergers and acquisitions and driving greater efficiency and profitability in the agricultural sector.

Agency Theory

Agency theory indicates that there are potential conflicts of interest between management (agent) and shareholders (principal). Larger boards are thought to provide better oversight and thus mitigate agency problems (Jensen and Meckling, 1976). This theory suggests that an increase in board size can strengthen corporate governance by providing diverse expertise and reducing the possibility of managerial opportunism.

According to the agency theory, if the proportion of external independent directors in the composition of the board of directors is larger, then the approval and supervision of management by the board of directors of listed companies on behalf of shareholders will be more effective and easier to achieve (Byrd and Hickman, 1992; Hilmana and Dalziel, 2003). Independent directors should mitigate these conflicts by providing objective oversight and ensuring that management is acting in the interests of shareholders. In the context of mergers and acquisitions, significant investments in a company's strategic direction may change. Independent directors can help ensure that decisions are not based on personal or management interests but on creating value for shareholders, and their presence may be particularly important in influencing and overseeing proposed acquisitions and resolving conflicts of interest between decision makers and shareholders (Jensen and Meckling, 1976).

Empirical Evidence on Factors Influencing Operating Performance of Companies Post-M&A

Board independence and Operating Performance

In previous studies, the research results on the impact of independent directors on corporate performance are different. There is a positive correlation between the proportion of independent directors and corporate financial performance (Pearce and Zahra ,1992; Millstein and MacAvoy, 1998). Boateng, Bi, and Brahma (2017) show that independent directors have a positive and significant impact on business performance during 12-36 months after M&A. Another study found that certain industries, such as high-tech companies, have improved operating performance after mergers and acquisitions, and appropriate board independence, a governance factor, has a positive impact on corporate performance (Lok et al., 2021).

However, Duchin, Matsusaka and Ozbas (2010) argue that the effectiveness of independent directors is limited by the insufficient information on corporate activities, corporate resources and capabilities, and the complexity associated with corporate operations. Chung, Judge and Li (2015) emphasize that the board of directors can fully play an advisory role but cannot adequately play its supervisory and management role. Pasko, Chen, and Wang (2021) found that board independence did not significantly impact financial performance in China.

Board Size and Operating Performance

After M&A events, the relationship between board size and financial performance has similar results in various literatures. Research by Zia ur Rehman (2020), including data from the Pakistani and Chinese banking sectors, shows that larger board sizes have a positive impact on key financial metrics such as return on assets (ROA) and return on equity (ROE) in the Chinese context. This finding highlights the potential benefits of large boards improving financial results following M&A activity in industries such as agriculture. Similarly, Pasko, Chen, and Wang (2021) found that the larger the board size, the better the financial performance. This study suggests that larger boards may help manage the complex dynamics and challenges that arise during and after mergers and acquisitions, promoting better integration and strategic oversight (Pasko, Chen, and Wang, 2021). Li and Sutunyarak (2023) show that a larger board can effectively oversee strategic financial initiatives that improve corporate performance, which is very consistent with the hypothesis of board size and financial performance after mergers and acquisitions.

Therefore, the hypothesis of this paper is consistent with the results of previous studies. Board size were significantly positively correlated with financial performance (using ROA, ROE, and EPS as proxies) (Pasko, Chen, and Wang, 2021).

Leverage and Operating Performance

Financial leverage refers to the extent to which a company uses borrowed funds to increase its profit margin. Companies benefit from the use of financial leverage through tax breaks and cost reductions, which have a positive impact on business performance. At the same time, leverage is also an important factor in determining a company's risk and return profile, and excessive leverage can hinder financial performance. After merger and acquisition, usually accompanied by the financial adjustment and debt restructuring of the enterprise, leverage will have a significant impact on the financial performance of the enterprise, which may be short-term impact or long-term impact, may be negative impact or may stabilize or enhance the financial health of the company. Murphy (1985) found a significant negative correlation between financial leverage and corporate profitability. Obia (2018) explored how leverage affected the EPS of Nigerian agricultural companies and pointed out the negative impact. Xu and Jin (2022) found in their research on Chinese agricultural enterprises that higher capital levels are associated with lower financial leverage and have a positive impact on corporate profitability. This suggests that in the post-merger period, managing leverage is critical to balancing financial health with strategic resource utilization. The above research contradicts the results of Moktar and Xiaofang (2014), who found that financial leverage is positively correlated with profitability and is significant.

These studies highlight the impact of leverage on financial performance after mergers and acquisitions, emphasize the necessity of strategic financial management, and show that effective leverage management is critical to improving the profitability of merged entities.

Control Variable

Firm size is typically measured in terms of total assets, revenue, or market capitalization, and it affects its market power, economies of scale, and management capabilities. Larger companies may find it easier to absorb and integrate another company, which could lead to greater changes in ROA. Larger companies may also have more resources to effectively manage post-merger integration.

It is believed that the size of the acquirer, the valuation of the acquirer, method of payment, transaction value, and acquirer price increases (buy-and-hold exceptional returns 12 months before the event) are important variables affecting performance of M&A (Core, Holthausen and Larcker, 1999; Core et al., 2006; Boateng and Bi, 2014; Du, Boateng and Newton, 2016). Therefore, firm size will be taken as the control variable in this paper.

Research Methodology

Research Design and Target Population

The study adopted a explanatory research design. In this study, data was collected before the start of the study, mainly from different agricultural listed companies in China. The reason for choosing the explanatory research design is that it can help explain the relationship between research variables such as mergers and acquisitions of listed Chinese agricultural companies and corporate performance, and predict the future development trend of Chinese agricultural listed companies based on the observed results. The study's target population included 283 mergers and acquisitions of listed Chinese agricultural companies between 2003 and 2019.

Sample Design and Sample Size

This study use a purposeful sampling method, where 77 mergers and acquisitions involving Chinese agricultural listed acquisition companies were investigated. The 76 companies included in the sample have specific characteristics required for this study. The acquirer and the acquiree must be listed on a Chinese stock exchange. After excluding companies that have been delisted and the acquirer is a listed agricultural enterprise but the acquired company is not an agricultural enterprise, 94 listed agricultural companies had 95 mergers and acquisitions from 2007 to 2019, and one listed agricultural company had mergers and acquisitions in 2007, 2008 and 2009 respectively. 2 in 2013, 9 in 2014, 6 in 2015, 15 in 2016, 12 in 2017, 3 in 2018, and 45 listed agricultural companies in 2019 had mergers and acquisitions. Due to missing data in some companies, 77 mergers and acquisitions occurred in 76 listed companies, including one listed company named Shandong Meichen Ecology & Environment Co., Ltd whose stock number is 300237, which occurs mergers and acquisitions in 2014 and 2019 respectively.

Data Collection and Analysis

The study used secondary data obtained from the Wind database and the Chinese Stock Market Research (CSMAR) database. In order to avoid the impact of mergers and acquisitions on corporate performance during the post-2020 epidemic period, the initial total sample was excluding overseas transnational mergers and acquisitions. According to the time of each company's merger and acquisition, the data for two years before, two years after the merger and acquisition and the year of M&A are selected, and the sample size is finally confirmed.

This study examines the effects of board independence, board size and leverage on the financial performance of listed Chinese agricultural enterprises after mergers and acquisitions, using two main analytical methods: descriptive analysis and hypothesis testing using ordered linear regression. Through the implementation of descriptive analysis, the central trend and variability of the distribution of key variables, such as board size, board independence, leverage ratio, ROA can be summarized statistically, including the calculation of the mean, median and standard deviation of each variable. Descriptive analysis clearly delineates the structural characteristics of the sample company and determines if there are any anomalies or outliers in the data that could affect subsequent analysis. In this study, ordinal linear regression was used to analyze the relationship between specific board characteristics (independence and size), leverage ratio, and financial performance (as measured by changes in return on assets) of listed Chinese agricultural companies after M&A.

Results and Discussion

Hypothesis 1 is accepted. There is a significant relationship between the independence of the board of directors and the financial performance of Chinese agricultural enterprises after M&A. This result highlights the importance of having a high proportion of independent directors on the board, while suggesting that for companies in the agricultural sector, increasing board independence can be a beneficial strategy for improving financial performance. In conclusion, by ensuring a high proportion of independent directors, companies can improve their governance structure and provide valuable insights for policymakers, managers and investors to make informed decisions about board composition, thereby improving the combined financial performance.

Hypothesis 2 is rejected. Board size had no significant effect on changes in ROA in the two years after the merger. The results show that the number of board members is not a key factor in determining post-merger financial performance. The results show that the increase or decrease of the number of directors has no significant effect on the financial results of mergers and acquisitions. This may be because the effectiveness of a board depends more on the quality and expertise of its members than on the absolute number of directors. It also means that companies may not need to change the size of their boards as a strategy to improve their post-merger financial performance. Factors such as board diversity, independence, and the presence of professional and technical staff are likely to play a more significant role in governance and decision-making, and thus affect financial performance more significantly.

Hypothesis 3 is accepted. Leverage has a significant positive effect on the change of ROA in the two years after M&A. Companies with higher leverage tend to experience an increase in ROA after a merger. This positive correlation means that leverage (which involves using borrowed funds) can improve a company's financial performance by increasing assets and the potential to generate returns. However, it is important to note that while higher leverage can bring higher returns, it also comes with higher risks that businesses need to manage carefully. The acceptance of this assumption underscores the importance of leverage as a factor affecting post-merger financial results. This suggests that for companies in the agricultural sector, leverage can be a beneficial strategy for improving financial performance. In summary, the significant positive effect of leverage on changes in total return on assets highlights the role of financial strategy in determining the success of mergers and acquisitions. It provides valuable advice to managers and investors in making informed decisions about capital structure and the use of debt to improve the performance of the combined company.

Conclusion

The main purpose of this study is to determine the influence of board independence, board size and leverage on the financial performance of Chinese agricultural listed enterprises after mergers and acquisitions. This result is consistent with previous research highlighting the positive impact of board independence on financial performance. For example, Lok et al. (2021) found that good governance, characterized by board independence, has a positive impact on firm performance in the high-tech industry. There is no significant relationship between board size and financial performance, and merely increasing or decreasing the number of board members is not enough to improve financial performance. The effectiveness of a board may depend more on the education, expertise and competence of its members than on its size. This finding is in contrast to Pasko, Chen, and Wang (2021), which found a positive correlation between larger board size and improved financial performance. The use of leverage, or debt financing, can provide the necessary capital for investment and expansion, driving growth and profitability. The positive correlation between leverage and total return on assets indicates that debt financing can effectively improve the financial performance after M&A as long as it is prudently managed and excessive risks are avoided. This finding is consistent with previous research highlighting the role of leverage in improving financial performance. For example, Vijayakumaran and Vijayakumaran (2019) found that leverage significantly affects the profitability of Chinese listed companies. These results underscore the importance of strategic financial management in using debt for growth and profitability after a merger.

In summary, this study makes a comprehensive analysis of the factors affecting the financial performance of China's agricultural sector after the merger and acquisition. The results of this study emphasize the importance of board independence and leverage ratio in achieving positive effects on financial performance after M&A. This study provides valuable advice and guidance to stakeholders involved in M&A activities such as business leaders, investors and others to ensure that the benefits of mergers and acquisitions are maximized and contribute to the overall health and growth of agriculture and the wider economy.

Contribution

This study has made a significant contribution to various theoretical frameworks for the study of the impact of M&A on financial performance of Chinese agricultural enterprises. By examining the factors that influence the outcome of agricultural M&A, this study enriches traditional M&A theory, enhances our understanding of corporate governance, and provides valuable insights into strategic management, organizational integration, and international business. The findings highlight the importance of effective governance and strategic financial management in achieving successful M&A outcomes. Through these contributions, this study not only deepens academic understanding, but also provides practical insights for managers and investors, ultimately supporting sustainable growth and development of the agricultural sector.

Recommendation for Further Study

It is suggested to extend the observation period of listed Chinese agricultural enterprises after M&A in the sample, and explore whether various variables have the same effect on financial performance as short-term results after M&A for many years. Furthermore, in addition to using accounting indicators to measure the operation of each agricultural listed company, the share price method can also be added to the research, because it is related to the interests of shareholders and investors.

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