RESEARCH ON THE RELATIONSHIP BETWEEN MANAGEMENT OVERCONFIDENCE, CORPORATE GOVERNANCE, AND M & A PREMIUM – AN EMPIRICAL TEST FROM CHINA'S A-SHARE LISTED COMPANIES

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Abstract

This article uses the listed companies that have undergone mergers and acquisitions in China's A-shares from 2014 to 2018 as a sample to empirically test the impact of management confidence on the M & A premium and corporate governance on the M & A premium. The research shows: (1) the higher the overconfidence of the management, the higher the premium generated during the merger; and (2) the higher the level of corporate governance, the lower the premium generated during the merger.

Based on the above conclusions on premiums, in order to better control the high premiums in corporate mergers and acquisitions, companies should avoid blind mergers and acquisitions, improve corporate governance, prevent mergers, and acquisitions premiums, establish a market value management system, and strengthen the overall supervision and management of regulatory agencies. In addition, they should pay attention to the comprehensive integration after the completion of mergers and acquisitions, and strengthen the risk awareness education of small and medium investors.

Keywords: Mergers and Acquisitions, Overconfidence, Corporate Governance, Merger

Introduction

With the impact of economic globalization, competition and cooperation between enterprises have also been continuously strengthened, and mergers and acquisitions have become an important means of rapid expansion of the scale of enterprises. Current research believes that high valuations and high premiums are the source of huge goodwill. With the wave of mergers and acquisitions in recent years, high valuations, high premiums, and high goodwill have become the norm. As the initiator of M & A activities, corporate management plays a leading role in the decision of M & A consideration. Most decision makers will be disturbed by psychological factors and deviate from rationality when making major decisions, resulting in obvious irrational deviations. The irrational psychological deviation formed

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by the overconfidence of the management is the most critical factor affecting the M & A decision. In the current academic literature on corporate governance, most of them focus on a specific aspect of corporate governance, such as the composition of the board of directors, the compensation of outside directors, investor protection, shareholder participation. However, corporate governance, as a governance system that balances the internal relationships of the enterprise, can adjust the self-interested behavior of the management by influencing the high premium motive of mergers and acquisitions when the principal-agent problem occurs between the major shareholders and the management. Good corporate governance can alleviate the company's agency problems and improve willingness and high-level decision-making efficiency. But the existing literature has not reached a consistent conclusion. In view of this, this article attempts to make a contribution in this regard, and will study the relationship between the corporate governance system of A-share listed companies, the overconfidence of the management and the M & A premium.

Research Objectives

Most scholars believe that management's overconfidence will overestimate the value of the target company and the expected return of the combined company. M & A activities based on the management's overconfidence will often result in a loss of the value of the master company (Song & Dai, 2015), easier to pay excessive premiums during mergers and acquisitions. Therefore, this article will further study the relationship between the perception of management overconfidence and high M & A premiums. Good corporate governance can alleviate the company's agency problems, improve willingness and high-level decision-making efficiency. In view of this, this article attempts to make a contribution in this regard, and will study the effect of A-share listed companies' corporate governance system on mergers and acquisitions premium and huge recognition of goodwill affect the relationship between.

Literature Review

To put it simply, China A shares are stocks purchased in RMB, issued by companies registered in China and listed in China, for omestic institutions, organizations or individuals to subscribe and trade in RMB. The impact of managers' overconfidence on M & A premiums mainly includes three aspects. First, overconfidence will cause managers to overestimate the expected future returns, and the greater the expected return, the more likely the acquirer will pay a high premium (Jiang & Zhang, 2009). M & A premium is the transaction cost that a company is willing to pay to obtain the private benefits of control and the expected benefits of mergers and acquisitions. When the expected benefits of mergers and acquisitions are greater, the merger premium paid by the acquirer is higher (Li, 2015). Second, because management often has more internal information than

external investors, it has rich management experience, better personal background and higher knowledge level. Therefore, overconfident management will think that their own ability can improve the synergy effect after M & A, they have more information than external investors, and that the market seriously underestimates the target company, thus paying a higher M & A premium (Bernardo & Welch, 2001). Third, overconfidence will make managers of the acquirer ignore potential risks and underestimate the potential risks in M & A transactions, making it easier to pay excessive M & A premiums (Liu & Chen, 2017). Managers are overconfident that the M & A premium and goodwill impairment paid in M & A decisions will be higher (Pan, Liu, & Wang, 2018). Therefore, this article believes that the more confident the management is in M & A, the higher the premium generated by M & A. Based on the above inferences, Propose Hypothesis 1.

H_1: Management overconfidence is positively correlated with high M & A premiums.

Corporate governance refers to a means of checks and balances of organizational structure relationships. As an institutional arrangement for regulating and supervising corporate behavior, corporate governance can play its role in correcting and checking management's irrational decision-making. If there is a conflict of interest between the management of the acquiring party and the shareholders, unreasonable merger premiums are likely to occur in the merger. Efficient corporate governance can play a positive role in regulating the expected synergies of mergers and acquisitions, effectively intervening in the management's overconfidence, and reducing the possibility of irrational decision-making behavior (Zhang & He, 2012). With the evolution of the shareholding structure, the principal-agent problem has gradually manifested itself as a major shareholder's infringement of the interests of small and medium shareholders. From the perspective of principal-agent, major shareholders' shareholding can reduce the occurrence of the first type of principal-agent problems, thereby affecting the merger premium and business price. Impairment of reputation can effectively curb management's personal gains (Shleifer & Vishny, 1986). The corporate governance structure means the effectiveness of mutual supervision and restraint between shareholders. A sound corporate governance system can restrict shareholders from seeking private interests for themselves to a certain extent, safeguard the interests of external investors, and ease conflicts of interest among shareholders. Achieve long-term business goals of the company (Sui, Jiang, & Xu, 2016). Sound corporate governance is the guarantee of internal supervision and control of the enterprise, and it also guarantees the consistency of the interests of management and external shareholders. Therefore, this article believes that a company with a more complete corporate governance system will have a lower premium due to mergers and acquisitions. Based on the above inferences, Propose Hypothesis 2.

H_2: Corporate governance is negatively correlated with high M & A premiums.

Methodology

2014 to 2018 is the year when China's listed companies have the most mergers and acquisitions. By 2018, the number of mergers and acquisitions market transactions reached 10,877 (Li, Ye, & Lu, 2018). This article selects all mergers and acquisitions of A-share listed companies from 2014 to 2018 as the total sample. The specific data sources are as follows: Samples of mergers and acquisitions, company-related financial data, corporate governance, and personal characteristics of managers are derived from the Cathay Pacific database and Wonder database; the book value of the target company's net assets and company performance are manually collected through merger announcements. For missing data, use Reese database is supplemented. In order to avoid the influence of extreme values on the conclusions of the research, herein for all continuous variables tail withdrawal (the Winsor) processing each of the upper and lower quartile 1%. In order to ensure the rigor of the research, the total sample was screened and removed: 1) Remove the sample of M & A transactions with an M & A transaction value of less than 1 million; 2) Remove the sample of M & A transactions with an acquisition ratio of less than 30%; 3) Remove M & A transaction samples of ST and ST; 4) Remove financial M & A transaction samples; 5) Remove M & A transaction samples with incomplete financial data indicators of both parties to the M & A transaction, and 6) Remove M & A transaction samples with negative net assets.

In the research model that discusses management overconfidence and M & A premium, this article takes management overconfidence (Ovc) as the explanatory variable, and M & A premium as the explained variable. For the measurement of explanatory variables, this article adopts the more commonly used management relative compensation method to measure the relative ratio of executive compensation. That is, the relative salary of executives = the sum of the top three executives' salaries/the sum of all executives' salaries (Makhija, Ferris, & John, 2013). For the measurement of the explained variable M & A premium (premium), this article selects the value of the acquired party's net assets as the measurement standard of the M & A premium, and uses the ratio of the part of the M & A transaction consideration to exceed the book value of the target company's net assets to the book value of the target company's net assets. Instead of M & A premium (Chen & Li, 2016), In this way, the overvalued value in the valuation process of the merger consideration can be calculated. According to the existing literature research, this paper selects enterprise scale (Size), enterprise growth (Growth), enterprise free cash flow (Cashflow), board size (Board), asset-liability ratio (Lever), year (Year), and industry (Ind) as control variables. Therefore, in order to discuss the impact of management overconfidence on M & A premium and M & A

confirmed goodwill, this paper establishes the following multiple linear regression model for Hypothesis 1:

$$Premium = \alpha_0 + \alpha_1 Ovc + \alpha_2 Size + \alpha_3 Growth + \alpha_4 Cashflow + \alpha_5 Board + \alpha_6 Lever + \alpha_7 Year + \alpha_8 Ind + \sigma_1$$

Corporate governance is a series of institutional arrangements to coordinate and supervise the interests of all parties. Therefore, a certain indicator cannot fully reflect the level of corporate governance. At present, most academic circles use principal component analysis to construct an index that can fully reflect the level of corporate governance. The principal component analysis method is used to construct the corporate governance index, and the first principal component obtained from the principal component analysis method is defined as an indicator of the level of corporate governance (Gov) (Zhou, 2011). Use the symbol Gov to represent the corporate governance index, and construct the following calculation formula:

$$Gov = -0.625 \times TOP1 + 0.595 \times Cstr2\_10 + 0.23 \times rindiret + 0.037 \times TOP50.227 \times parent + 0.023 \times dua + 0.071 \times HB$$

According to the existing literature research, this article selects the scale of the enterprise (Size), the growth of the enterprise (Growth), the free cash flow of the enterprise (Cashflow), the debt-to-asset ratio (Lever), the proportion of major shareholders (Otac), the year (Year), and the industry (Ind) etc. Control variable. Therefore, in order to discuss the impact of corporate governance on M & A premiums and M & A's confirmation of goodwill, this article establishes the following multiple linear regression model for Hypothesis 2:

$$Premium = \alpha_0 + \alpha_1 Gov + \alpha_2 Size + \alpha_3 Growth + \alpha_4 Cashflow + \alpha_5 Lever + \alpha_6 Otac + \alpha_7 Year + \alpha_8 Ind + \sigma_1$$

Results

In the process of discussing the impact of management overconfidence and M & A premiums, this article collected data from 487 companies listed on China's A-shares from 2014 to 2018, and carried out descriptive analysis and correlation analysis on them, as well as with the help of Excel and STATA15. 0 Perform multiple linear regression, and get the following results through data testing.

Table 1 Descriptive analysis table of management overconfidence and M & A premium

Variable	N	Mean	Median	Min	Max
Premium	487	9.014	4.752	0	102.3
Ovc	487	0.503	1	0	1
Board	487	8.109	9	5	11
Cashflow	487	0.094	0.051	0	0.662
Growth	487	0.239	0.134	-0.53	3.522
Lever	487	0.314	0.280	0.026	0.859
Size	487	20.89	20.79	19.24	23.33
Year	487	2016	2015	2014	2018
Ind	487	20.11	16	1	55

In this paper, the 1% wins or extreme values before and after all variables are used. The descriptive statistical analysis is shown in Table 1. The average value of M & A premium (premium) is 9.014, the median is 4.752, the maximum is 102.3, and the minimum is 0.The average value of management overconfidence (Ovc) is 0.503, the median is 1, the maximum value is 1, and the minimum value is 0, indicating that more than half of the listed companies with A-share mergers and acquisitions have management overconfidence. Through the Pearson correlation test, the correlation results of management overconfidence and M & A premium are shown in Table 2 below:

Table 2 Analysis of the correlation between management overconfidence and M & A premium

	Premium	Ovc	Board	Cashflow	Growth	Lever	Size	Year	Ind
Premium	1								
Ovc	0.091**	1							
	0.0446								
Board	0.0390	-0.120**	1						
	0.389	0.00800							
Cashflow	-0.0650	0.0720	-0.0260	1					
	0.151	0.115	0.572						
Growth	-0.0400	-0.0600	0.0070	0.080*	1				
	0.375	0.189	0.872	0.0772					
Lever	-0.0680	0.00400	0.090**	0.0590	0.0310	1			
	0.136	0.925	0.0469	0.192	0.501				
Size	0.0270	-0.101**	0.168**	-0.0320	0.00500	0.458**	1		
	0.546	0.0261	0.0002	0.487	0.917	0			
Year	0.0220	0.146***	-0.0470	0.132***	-0.0160	-0.0210	-0.176**	1	
	0.634	0.00120	0.296	0.00360	0.729	0.645	0.00010		
Ind	0.113**	-0.0670	-0.0160	-0.0580	-0.0160	-0.100*	-0.00900	0.0150	1
	0.0128	0.142	0.718	0.202	0.726	0.0272	0.850	0.735	

From the correlation analysis in Table 2 above, we can see that the correlation coefficient between management's overconfidence and M & A premium is 0.091**, showing a significant positive correlation. Management's overconfidence will affect the payment premium during M & A. Tested H1 to a certain extent. From the perspective of the correlation coefficients between the control variables and the explanatory variables in the research model and the explained variables, most of the control variables selected in this article show significant correlations, and the selection of control variables is more appropriate. From the perspective of the entire correlation analysis, although there is a significant correlation, the correlation coefficient is

not high, and it is statistically independent. Before performing linear regression analysis, test the multicollinearity between the control variables and the independent variables. To prevent the occurrence of multicollinearity problems, the results are shown in Table 3 below:

Table 3 Multicollinearity between management overconfidence and M & A premium

Variable	VIF	1/VIF
Size	1.35	0.741948
Lever	1.30	0.771761
Year	1.07	0.934416
Ovc	1.05	0.949763
Board	1.04	0.960039
Cashflow	1.04	0.965311
Ind	1.02	0.980542
Growth	1.01	0.987937
Mean VIF	1.11	

It can be seen from Table 3 that in terms of collinearity test, all control variables, independent variables VIF values and Mean VIF values are less than 10 and all greater than 0, indicating that there is no multicollinearity problem among the variables, and multiple linear regression can be performed analysis.

Table 4 Multiple regression table of management overconfidence and M & A premium

COEFFICIENT	Premium
Ovc	3.284**
	(1.36)
Board	0.553
	(0.51)
Cashflow	-7.426
	(5.74)
Growth	-0.669
	(1.22)
Lever	-7.144*
	(3.98)
Size	1.316
	(0.90)
Year	0.269
	(0.50)
Ind	0.133**
	(0.056)
Constant	-567.3
	(1019)
Observations	487
R-squared	0.04

t-statistics in parentheses *** p<0.01, ** p<0.05, * p<0.1

From Table 4 above, it can be seen that the P value of the regression between management overconfidence and M & A premium is 3.284**, and the regression coefficient is 1.36. The regression shows that among listed companies, the more serious the management overconfidence, the more serious the M & A payment will be the higher the premium, there is a significant positive correlation between management overconfidence and the M & A premium. In order to verify the reliability of the conclusion of H1, this paper adopts the method of replacing the control variables to conduct a robustness test, increasing the nature of equity, whether the merger and reorganization is a related transaction, the largest shareholder's shareholding ratio and other new control variables, and then re-analyze the management overconfidence and the merger premium. The results of the robustness test are shown in Table 5.

Table 5 Robustness test of management overconfidence and M & A premium regression

Coefficient	Premium
Ovc	3.317**
	(1.39)
State	-3.580
	(2.40)
Rit	-2.098
	(1.41)
Top1	0.0579
	(0.053)
Board	0.646
	(0.52)
Cashflow	-5.548
	(5.95)
Growth	-0.784
	(1.21)
Lever	-6.313
	(4.04)
Size	1.670*
	(0.93)
Year	0.378
	(0.54)
Ind	0.145**
	(0.058)
Constant	-795.7
	(1082)
Observations	447
R-squared	0.06

t-statistics in parentheses *** p<0.01, ** p<0.05, * p<0.1

From Table 5 above, it can be seen that after the robustness test, the regression P value of management overconfidence and M & A premium is 3.317**, and the regression coefficient is 1.39. There is still a significant positive correlation between management overconfidence and M & A premium. This shows that this article. The results of empirical research are relatively robust, and the postponed hypothesis H1 of this article is tested again.

Table 6 Descriptive Analysis of Corporate Governance and M & A Premium

Variable	N	Mean	Median	Min	Max
Premium	463	8.962	4.746	0.05	99.29
Gov	463	0.894	0.916	-1.30	3.003
Otac	463	0.069	0.026	0	0.503
Cashflow	463	0.091	0.049	0	0.662
Growth	463	0.241	0.142	-0.53	3.522
Lever	463	0.312	0.279	0.02	0.859
Size	463	20.90	20.81	19.2	23.33
Year	463	2016	2015	2014	2018
Ind	463	19.94	16	1	55

In this paper, the 1% wins or extreme values before and after all variables are used for processing, and the descriptive statistical analysis is shown in Table 6. The average value of M & A premium (premium) is 8.962, the median is 4.746, the maximum is 99.29, and the minimum is 0.05. The average value of corporate governance (Gov) is 0.894, the median is 0.916, the maximum value is 3.003, and the minimum value is -1.30, indicating that the corporate governance index of listed companies undergoing A-share mergers and acquisitions is relatively low, or even negative, indicating that corporate governance is generally better weak. Through the Pearson correlation test, the correlation result between the corporate governance structure and the M & A premium is shown in Table 7 below:

Table 7 Correlation Analysis of Corporate Governance and M & A Premium

	Premium	Gov	Otac	Cashflow	Growth	Lever	Size	Year	Ind
Premium	1								
Gov	-0.081*	1							
	0.0827								
Otac	0.0160	-0.106**	1						
	0.728	0.0222							
Cashflow	-0.0570	-0.0590	0.079*	1					
	0.218	0.206	0.0879						
Growth	-0.0410	0.00100	-0.0110	0.0610	1				
	0.374	0.978	0.813	0.188					
Lever	-0.0680	-0.284***	0.335***	0.0740	0.0360	1			
	0.141	0	0	0.112	0.436				

Table 7 Correlation Analysis of Corporate Governance and M & A Premium (Cont.)

	Premium	Gov	Otac	Cashflow	Growth	Lever	Size	Year	Ind
Size	0.0330	-0.395***	0.271***	-0.00600	0.0100	0.448***	1		
	0.473	0	0	0.898	0.837	0			
Year	0.0210	0.097**	0.0220	0.102**	-0.0180	-0.0390	-0.177***	1	
	0.647	0.0369	0.640	0.0280	0.703	0.407	0.000100		
Ind	0.126***	-0.0460	-0.0530	-0.0520	-0.00700	-0.106**	-0.00200	0.00600	1
	0.00650	0.324	0.253	0.266	0.874	0.0226	0.961	0.900	

From the correlation analysis in Table 7 above, it can be seen that the correlation coefficient between corporate governance and M & A premium is -0.081*, showing a significant negative correlation. The level of corporate governance will significantly affect the generation of premium in M & A payment consideration. Tested H2 to a certain extent. From the perspective of the correlation coefficients between the control variables and the explanatory variables in the research model and the explained variables, most of the control variables selected in this paper show significant correlations, and the selection of control variables is more appropriate. Before performing linear regression analysis, test the multicollinearity between the control variables and the independent variables. To prevent the occurrence of multicollinearity problems, the results are shown in Table 8 below:

Table 8 Multicollinearity table of corporate governance and M & A premium

Variable	VIF	1/VIF
Size	1.46	0.683336
Lever	1.38	0.722822
Gov	1.22	0.820089
Otac	1.16	0.860419
Year	1.05	0.951320
Cashflow	1.03	0.969701
Ind	1.02	0.978854
Growth	1.01	0.993704
Mean VIF	1.17	

It can be seen from Table 8 that in terms of collinearity test, all control variables, independent variables VIF values and Mean VIF values are less than 10 and all greater than 0, indicating that there is no multicollinearity problem among the variables, and multiple linear regression can be performed. Analysis the main model regression analysis results are shown in Table 9:

Table 9 Multiple regression table of corporate governance and M & A premium

Coefficient	Premium
Gov	-1.353**
	(0.66)
Otac	4.954
	(7.26)
Cashflow	-5.210
	(5.81)
Growth	-0.913
	(1.19)
Lever	-6.003
	(4.09)
Size	1.794*
	(0.94)
Year	0.312
	(0.50)
Ind	0.146***
	(0.056)
Constant	-659.4
	(1019)
Observations	463
R-squared	0.04

t-statistics in parentheses *** p<0.01, ** p<0.05, * p<0.1

It can be seen from Table 9 above that the regression P value of corporate governance and M & A premium is -1.353**, and the regression coefficient is 0.66. The regression shows that among listed companies, the better the corporate governance level, the more M & A premium paid during the M & A process. There is a significant negative correlation between corporate governance and M & A premium. The results test the research hypothesis H2 proposed in this paper.

In order to verify the reliability of conclusion H2, this paper takes the median value of M & A premiums in the full sample, assigns a value of 1 to the value of 1 for high-premium M & A groups, and assigns a value of 0 to low-premium M & A groups. Group, and then re-ran the binary logistics regression analysis on management's overconfidence and M & A premium. The results of the robustness test are shown in Table 10 below:

Table 10 Robustness test of dual logistics regression of corporate governance and M & A premium

Variables in the Equation									
		B	Standard Error	Wald	Degree of Freedom	Significance	Exp (B)	EXP (B) 95% Confidence interval	
								Lower limit	Upper limit
Step 1	Gov	-.202	.095	4.525	1	.033	1.224	1.016	1.474
	Otac	.047	.974	.002	1	.961	1.049	.156	7.070
	Cashflow	.558	.770	.524	1	.469	1.747	.386	7.907
	Growth	-.125	.130	.927	1	.336	.882	.683	1.139
	Lever	.207	.580	.128	1	.721	1.230	.395	3.834
	Size	-.200	.133	2.274	1	.132	.818	.631	1.062
	Year	-.023	.072	.103	1	.748	.977	.848	1.126
	Ind	.004	.008	.217	1	.641	1.004	.988	1.020
	Constant	50.738	146.230	.120	1	.729	0.000		

a. Variables entered in step 1: Gov, Otac, Cashflow, Growth, Lever, Size, Year, Ind

It can be seen from Table 10 above that, after the robustness test, the regression P value of corporate governance and M & A premium is 0.033, which is less than 0.05, and the beta value is -0.202. Corporate governance and M & A premium are still significantly negatively correlated, indicating the empirical evidence of this article. The research results are relatively robust, and the postponed hypothesis H2 of this article is tested again.

Discussion

This article mainly first conducts descriptive analysis and correlation analysis on the collected data. In the descriptive analysis, it is shown that most of the data presents a normal distribution, indicating that the data range is relatively reasonable. In the correlation analysis, although most of the data have a certain correlation, the correlation coefficient is not high, and it is statistically independent. After that, multiple linear regression analysis and binary logistics regression analysis were used to perform regression analysis on the research model proposed in this paper. The regression results show that the H1 and H2 proposed in this paper have been well verified, and the model has good robustness.

Conclusion

This paper takes China's A-share non-financial listed companies from 2014 to 2018 as the research object. Through empirical research, two conclusions are drawn: First, the overconfidence of management and the level of corporate M & A premiums show a significant positive correlation. The higher the level of overconfidence, the higher the M & A premium paid in mergers and acquisitions. Second, there is a significant negative correlation between corporate governance and corporate M & A premiums. The better the corporate governance structure, the lower the M & A premium paid in mergers and acquisitions.

Enterprise management is the leader in business decision-making. Due to information asymmetry, different personal characteristics will cause management to have different cognitive biases. Over-confident management will overestimate their own abilities, overestimate the profitability of M & A projects, and underestimate the risks of the project, resulting in unreasonable M & A premiums. A sound corporate governance level can effectively reduce the premium paid for mergers and acquisitions. Therefore, the level of corporate governance should be improved to reduce the adverse effects of the principal-agent problem on the synergy of mergers and acquisitions. Improve corporate supervision mechanisms to prevent overconfident management from making unreasonable decisions in corporate mergers and acquisitions. At the same time, the supervision and guidance role of the market economy should be brought into play to guide enterprises in investment decision-making activities to avoid the huge premium in mergers and acquisitions caused by the overconfidence of the management. The research in this article has deepened the relevant literature on M & A premiums, and provided new possible explanations for the impact of management's overconfidence and corporate governance on M & A payment premiums. It has certain enlightening significance for China's A-share M & A decisions, and at the same time has implications for investment. The relevant decision-making of the author also has certain reference value.

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