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Do Cross Border Integrated Acquisition Really Create Value in Emerging Market?

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Abstract: The aim of the paper is to study the value created by foreign shareholders in Indonesia finance company industry over the period 2001-2015. We analysed the value creation of related and unrelated foreign shareholders by comparing the key financial performance. We analysed 7 micro key financial ratios (profitability, efficiency, growth, firm size, liquidity, solvency and asset quality). We use non parametric Mann Whitney and parametric panel data dummy regression. The empirical results show that finance companies owned by integrated foreign shareholders are better in efficiency, but lower in profitability, smaller in size, lower in liquidity and solvency.

Keywords: Foreign Investment, Financial Ratio, Integration, Panel Data

JEL Classification Code: C33, F23, G21, G32, G34

1. INTRODUCTION

Indonesia finance company industry has evolved from Rp37 trillion in 2001 to Rp221 trillion in 2010 with compounded annual growth rate (CAGR) of 122%. The financing contribution to Indonesia's gross domestic product has reached a value of 3.59% (Nuryartono 2012). The financing contribution to the total national credit Indonesia reached 12.5% in 2011.

The finance company industry is highly dependent on two other industries, the banking industry and the automotive industry. Banking industry serves as the major funding source for finance companies, ranging from 78% to 91% in the last eight years. Finance company industry is also an industry where demand is a derived demand (Hutabarat, 2012). Financing must involve underlying transaction or product and it may not provide financing or loans without any solid occurrence of transaction of goods or services.

Are there differences in the character of a related value chain foreign owned finance company compared to the ones with unrelated value chain foreign ownership? Given that with the foreign ownership,

funding sources of finance companies become more competitive as compared to being entirely dependent on domestic funding sources. The second consideration is that the products financed by finance companies are products of foreign production.

This study becomes unique by examining the value brought by the foreign shareholders to Indonesia finance company industry. Research on the financial performance difference between foreign and local acquirer is still uncommon. Among some examples are Vander Vennet (2002), Montreevat and Rajan (2003), Haryanto (2007), Wu (2008), Correa (2009), Becalli (2008), Kalluru and Bhat (2009), Tahir et al. (2010), and Wanniarachchige and Suzuki (2011)

Vander Vennet (2002) stated that European banks gain increased profits resulting from the influence of parent companies. This study found no change in the efficiency ratio. This study was done on sixty-two samples that did mergers and acquisitions between the years 1990 - 2001 in thirty-four European Union state members.

Montreevat and Rajan (2003) conducted a research on the implications of foreign bank penetration in Thailand banks after two crisis in the 1980's and 1990's. This study found that the penetration of foreign banks in Thailand banks have lowered its cost structure, increased efficiency and improved corporate governance system. Foreign banks have also introduced new products, new technologies and management expertise to the domestic banking system.

Haryanto (2007) stated that the number of ownership and country of shareholders had implications on the performance of the company after the acquisition occurs. The research was conducted on French companies that were acquired by companies from the United States, Britain, Italy and Germany between the years 1995 to 2000.

Wu (2008) found that foreign banks participated in building the country's economy with the ability to choose productive industrial sectors. The study was conducted from 1996-2003 with a sample of thirty-five emerging market countries.

Kalluru and Bhat (2009) found that the penetration of foreign banks in the banking industry in India, has increased the profitability of the banking industry, overhead costs and non-performing loans increase. The research was conducted from 1996-2007.

Tahir *et al.* (2010) researched about differences between the performance of domestic banks and foreign banks in Malaysia between 2000 and 2006. Domestic banks have higher margin and operating costs compared to foreign banks. Foreign banks also have a better profitability ratio compared to domestic banks. Domestic banks also have a better efficiency ratio compared to foreign banks.

Wanniarachchige and Suzuki (2011) found that domestic banks and the government have worse performance than the foreign banks in India. Foreign banks have better performance in both aspects of cost efficiency and revenue efficiency. The research was conducted from 2002-2009.

Soussa and Wheeler (2006) found that cross-border studies observe that the acquisition of banks in developing countries is not profitable on average. Kim and Lee (2004) observed the banking industry in South Korea from 1999 to 2001. This study found that there were no significant differences between corporate governance and profitability improvement of foreign banks and domestic banks. This study found that the penetration of foreign banks in Korea only results in better banking system.

Correa (2009) conducted a study of two hundred twenty transactions of cross border mergers and acquisitions between the years 1994 to 2003. This study found that banking performance targets did not experience any increase in the first two years compared to companies that did not do mergers and acquisitions. Banks in developed countries experienced decreased net interest margin while banks in developing countries experienced increased overhead costs.

Becalli (2008) found that banks are more likely to make acquisitions in the country that gives freedom to investors and have clear and qualified regulations. To achieve efficiency, the merger and acquisition transactions must be conducted in the local market, transactions must be paid with equity and they have to focus on traditional banking activities.

Hagendorfl and Keasey (2009) found that cross-border acquisitions by parent companies from the United States were focused on increasing revenue while parent companies from Europe were focused on improving efficiency. The acquisition by parent companies from the United States did not show changes in performance on the target company, while acquisitions made by parent companies from Europe improved the performance of the target company.

Although there are already numerous researches concerning the financial performance of an acquisition and ownership by a foreign investor, there is no conclusive result yet. Therefore, it is important to conduct a research on this topic, especially in a specific industry with acquirers from related industry.

This paper will study the financial performance of finance company industry in Indonesia during 2001-2015. The performance measurement comparison will be based on four categories, which are between integrated and unintegrated foreign firms

The financial measurement are grouped into 7 dimensions, which are profitability, efficiency, solvency, liquidity, size, growth and asset quality. The rest of the paper will be organized as follows, after the introduction, we describe the data and methodology in Section 2, followed by the result and discussion in Section 3. Finally, Section 4 gives summary and conclusion remarks.

2. METHODOLOGY, VARIABLE AND DATA

2.1. Methodology

2.1.2. Dummy Variable Regression

Parametric test model in this study is developed from the dummy regression model by Vennet (2002). The variables in this study refer to seven measurements on profitability, size, efficiency, liquidity, solvency, growth and asset quality. The five ratios were developed by Healey et al. (1992), Cornet and Tehranian (1992, 2004) and Cheng (2006). This study adds in the variable of growth developed by Mandelker (1972) and a variable of size developed by Vennet (2002). These variables are adapted and developed into seven measurement ratio groups with seventeen research variables.

To test the financial performance between related and unrelated foreign owned finance companies, related foreign owned companies are coded differently from unrelated foreign owned finance companies (DO = dummy). DO code for related foreign owned = 1, code for unrelated foreign owned = 0. Financial performances are studied based on the ratio of growth, efficiency ratio, solvency ratio, liquidity ratio, size

ratio, profitability ratios, and asset quality ratio. Each of the financial indicators is tested parametrically and non-parametrically. Parametric tests are conducted by dummy regression towards each variable by the equation as follow :

Model 1a :

$$Y_{it} = a + b_1 DO_{it} + \varepsilon \quad (1)$$

Model 1b :

$$Y_{it} = a + b_1 DO_{it} + b_2 FSI_{it-1} + b_3 TAGR_{it-1} + \varepsilon \quad (2)$$

Where

Y_{it} = EXIR, ROA, ROE, NPM, PROV, LEV, PATA, LIQ, EXPA, REPA, LITA, FSI, TAGR, PAGR, NIGR, REGR, EXGR

DO = dummy ownership, 1 for related foreign ownership
0 for unrelated foreign ownership

FSI = Firm Size

TAGR = Total Asset Growth

Hypothesis:

There were no differences between the finance companies financial performance of integrated foreign firms and unintegrated foreign firms.

Financial indicators to be tested in this study are Profitability Ratio, Efficiency Ratio, Growth Ratio, Ratio Liquidity, Provisioning Ratio, Solvability Ratio, and Firm Size.

2.1.2. Non-Parametric Mann Whitney Test

Non-parametric test model in this study follows the model developed by Chang (2006), Wang (2007) and Hagedorff and Keasey (2009). This research model will focus on the performance difference between the two groups of independent and paired sample.

This test aims to test the characteristics between the 2 groups of independent samples. Mann Whitney test is an alternative testing to the t test without any restriction. This test can also apply for a different number of samples tested in the 2 groups.

Mann Whitney U formula test

$$U = n_1 n_2 + \frac{n_1(n_1+1)}{2} - R_1 \quad (5)$$

or

$$U = n_1 n_2 + \frac{n_2(n_2+1)}{2} - R_2 \quad (6)$$

where:

n_1 = number of sample 1

n_2 = number of sample 2

R_1 = number of ranks of the sample 1

R_2 = number of ranks of the sample 2

Non-parametric test performed with Mann Whitney Test

Using $\alpha = 5\%$

- Based on the t-statistics value and p-value, the variables that are significantly different between the integrated and independent companies will be noticeable.

2.2. Variable and Measurement

The five ratios were developed by Healey *et al.* (1992), Cornet and Tehranian (1992, 2006) and Cheng (2006). This study adds in the variable of growth developed by Mandelker (1972) and a variable of size developed by Vennet (2002). These variables are adapted and developed into seven measurement ratio groups with 17 research variables. This development is adjusted to finance industry ratio (table 1).

Table 1
Financial Ratios

<i>Ratio</i>	<i>Definition</i>
Growth Ratio	
Revenue Growth	$REGR = \frac{Revenue(t) - Revenue(t-1)}{Revenue(t-1)}$
Total Asset Growth	$TAGR = \frac{Total Asset(t) - Total Asset(t-1)}{Total Asset(t-1)}$
Net Income Growth	$NIGR = \frac{Net Income(t) - Net Income(t-1)}{Net Income(t-1)}$
Productive Asset Growth	$PAGR = \frac{Productive Asset(t) - Productive Asset(t-1)}{Productive Asset(t-1)}$
Productive Assets To Total Assets	$PATA = \frac{Productive Asset}{Total Asset}$
<i>Efficiency Ratio</i>	
Expense Income Ratio	$EXIR = \frac{Expense}{Income}$
Expense to Productive Assets	$EXPA = \frac{Expense}{Productive Asset}$
Expenses Growth	$EXGR = \frac{Expense(t) - Expense(t-1)}{Expense(t-1)}$

Solvency Ratio

Liabilities Total Assets
$$LITA = \frac{\text{Total Liabilities}}{\text{Total Asset}}$$

Leverage Ratio
$$LEV = \frac{\text{Total Liabilities}}{\text{Total Equity}}$$

Asset Quality

Provisioning Policy
$$PROV = \frac{\text{Total Provisioning}}{\text{Total Productive Asset}}$$

Size Ratio

Firm Size
$$FSI_t = \ln \text{Total Asset (t)}$$

$$FSI_{t-1} = \ln \text{Total Asset (t - 1)}$$

Liquidity Ratio

Liquidity Ratio
$$LIQ = \frac{\text{Total Productive Asset}}{\text{Total Liabilities}}$$

Profitability Ratio

Return on Assets
$$ROA = \frac{\text{Net Income}}{\text{Total Asset}}$$

Return on Equity
$$ROE = \frac{\text{Net Income}}{\text{Total Equity}}$$

Net Profit Margin
$$NPM = \frac{\text{Interest Income} - \text{Cost of Fund} - \text{Expenses}}{\text{Interest Income}}$$

Revenue to Productive Assets Ratio
$$REPA = \frac{\text{Revenue}}{\text{Total Productive Asset}}$$

2.3. Data

This study uses secondary data collected from various institutes and official literature which include financial data of each company published on various mass media, annual reports for public companies, research reports from various securities, research reports from magazines and Bloomberg database particularly regarding mergers and acquisition transactions.

The data are panel data consisting of cross section data from an observed period of the year 2001-2015. Some of the above data are obtained by using a calculation. The formulation of these variables is presented in Table 1.

The data used in this study is panel data. Panel data are two-dimensional data and the combination of time dimension (time series) and individual company dimension (cross section).

All finance companies in Indonesia that published the financial statements in 2001 to 2015 are the objects of the research. The number of companies registered with Bapepam LK is one hundred and ninety-three companies. The sampling criteria are as follows:

1. Finance companies listed on the Capital Market and Financial Institution Supervisory Agency (Bapepam- LK) / Otoritas Jasa Keuangan in 2015.
2. Finance companies that actively published financial statements during the period of 2001 to 2015.
3. Finance companies that announced the actions of corporate acquisitions during the period 2001 - 2015 in various mass media channels or annual report.

The sampling unit is finance companies. The sampling frame is the list of companies listed on the Bapepam-LK / Otoritas Jasa Keuangan and those that published financial statements for the period of 2001-2015. The sampling size is the total of all finance companies listed at the Bapepam-LK / Otoritas Jasa Keuangan and met the specified criteria.

This study uses purposive sampling with judgment sampling. Samples must meet certain criteria established in this study.

3. ANALYSIS AND DISCUSSION

3.1. Differences in Financial Performance of Foreign Related and Unrelated Finance Companies

The results of data processing on several ratio measurements show significant differences between finance companies owned by foreign related and unrelated shareholders. Data processing uses non-parametric tests (Mann Whitney) and parametric panel data.

Efficiency Ratio

With Mann Whitney test (MW) as shown in table 2, EXIR obtains a statistical value of -2.254 and is significant at $\alpha = 5\%$. With parametric test (pooled least squares), EXIR aspect obtains statistical value of -0.293 with $\alpha = 10\%$. By adding the variables FSI (1) and TAGR (1) on the parametric test (pooled least square), EXIR aspect obtains statistical value of 0.269 with $\alpha = 10\%$. These results show there are real differences between EXIR ratio of finance of finance companies owned by shareholders with related value chain business and unrelated shareholders. EXIR ratio of finance companies owned by related shareholders is smaller than that of finance companies with unrelated shareholders. Related finance companies have a more efficient performance compared to unrelated finance companies. EXIR shows a ratio of operating expenses to operating income.

With Mann Whitney test (MW), EXPA obtains a statistical value of -5.490 and is significant at $\alpha = 1\%$. With parametric testing pooled least square, EXPA aspect obtains statistical value of -0.225 with $\alpha = 1\%$. By adding the variables FSI (1) and TAGR (1) on the parametric test (pooled least squares), EXPA aspect obtains statistical value of -0.169 with $\alpha = 1\%$. These results show that there are real differences between EXPA ratio of finance companies owned by shareholders with related value chain business and unrelated shareholders. EXPA ratio of finance companies with related shareholders is smaller

than that of finance companies with unrelated shareholders. Related finance companies have a better efficiency ratio compared to unrelated finance company. EXPA shows a ratio of operational costs of productive assets.

With Mann Whitney test (MW), PATA obtains a statistical value of -4.054 and is significant at $\alpha = 1\%$. With parametric tests (pooled least square), PATA obtains a statistical value of -0.308 obtained with the real level of 1%. By adding a variable FSI (1) and TAGR (1) on the parametric test (pooled least squares), aspects of the statistical value of -0.299 PATA with $\alpha = 1\%$. These results show there are real differences between PATA ratio of finance companies owned by shareholders with related value chain business and unrelated shareholders. PATA ratio of finance companies owned by related shareholders is higher than that of finance companies with unrelated shareholders. Related finance companies have a better asset allocation ratio compared to related finance companies. PATA shows a ratio of productive assets to total assets.

Tabel 2
Test Results on The Differences in Financial Performance of Related and Unrelated Foreign Owned Finance Companies

No.	Variable	Non Parametric (Mann Whitney)		Parametric (Pooled Least Squared)			
				Model 1a		Model 1b	
1	EXIR	-2,254	**	-0,293	*	-0,269	*
				(0,179)		(0,143)	
2	ROA	-0,632		-0,021		0,031	
				(0,046)		(0,034)	
3	ROE	-0,723		0,305		0,464	
				(0,420)		(0,463)	
4	NPM	-0,824		-0,024		0,023	
				(0,081)		(0,081)	
5	PROV	-0,783		0,017		0,027	
				(0,027)		(0,030)	
6	LEV	-4,662	***	26,660		29,133	
				(21,153)		(23,752)	
7	PATA	-4,054	***	0,069	***	0,053	***
				(0,024)		(0,199)	
8	LIQ	-2,165	**	-12,233	***	-11,053	**
				(4,710)		(5,141)	
9	EXPA	-5,490	***	-0,224	***	-0,169	***
				(0,072)		(0,067)	
10	REPA	-5,480	***	-0,204	***	-0,173	***
				(0,065)		(0,070)	
11	LITA	-3,454	***	0,091	**	0,073	*
				(0,045)		(0,042)	

contd. table 2

Do Cross Border Integrated Acquisition Really Create Value in Emerging Market?

No.	Variable	Non Parametric (Mann Whitney)	Parametric (Pooled Least Squared)	
			Model 1a	Model 1b
12	FSI	-1,726 *	0,399 * (0,237)	0,107 (0,093)
13	TAGR	-0,486	-1,344 (1,382)	-1,595 (1,551)
14	PAGR	-0,017	0,398 (1,937)	0,768 (2,160)
15	NIGR	-0,681	-3,081 (2,869)	-3,833 (3,215)
16	REGR	-0,343	-2,901 (2,268)	-3,496 (2,545)
17	EXGR	-0,010	-3,937 (2,945)	-4,723 (3,303)

Note :

- 1) Dummy estimation coefficient (1 for related foreign owned finance companies and 0 for non related foreign owned finance companies)
- 2) Numbers in () states the estimated standard error
- 3) *) Significant at 10% level
 **) Significant at 5% level
 ***) Significant at 1% level

The significant results of Pooled Least Squared (PLS) will be re-tested using Fixed Effect Model (FEM) dan Random Effect Model (REM) test. Afterwards, The Chow test, Hausman test and LM test will be used to compare the results between PLS and FEM, between REM and FEM and between PLS and REM respectively.

Growth Ratio

No significant differences were found for the growth ratio of finance companies owned by related and unrelated shareholders. Both type of firms have the similar growth conditions.

Solvency Ratio

With Mann Whitney test (MW), LEV obtains a statistical value of -4.662 and is significant at $\alpha = 1\%$. These results show there are real differences between LEV ratio of finance companies owned by shareholders with related value chain business and unrelated shareholders. LEV ratio of finance companies owned by related shareholders is smaller than that of finance companies with unrelated shareholders. Related finance companies have a higher ratio of LEV compared to unrelated finance companies.

With Mann Whitney test (MW), LITA obtains a statistical value of -3.454 and is significant at $\alpha = 1\%$. With parametric testing (pooled least square), LITA obtains a statistical value of 0.091 with

Table 3
Panel Data Test Results

Variable	Model 1 a			Test			Selected Model
	PLS	FEM	RFM	Chow	Hausman	LM	
EXIR	-0.293 *	0.037	-0.291	1.39 *	0.22	2.75 *	PLS
EXPA	-0.225 ***	0.923 ***	0.024	6.35 ***	19.92 ***	115.36 ***	FEM
PATA	0.069 ***	-0.308 ***	0.011	5.22 ***	18.27 ***	96.47 ***	FEM
REPA	-0.204 ***	0.758 ***	0.155	6.67 ***	15.56 ***	17.34 ***	FEM
LIQ	-12.232 ***	1.843	-11.68 **	1.87 ***	0.57	10.95 ***	REM
LITA	0.091 **	0.014	0.082	4.68 ***	0.23	116.48 ***	PLS
FSI	0.398 *	-1.155 *	-0.2	12.12 ***	3.46 *	413.46 ***	FEM

Variable	Model 1 b			Test			Selected Model
	PLS	FEM	REM	Chow	Hausman	LM	
EXIR	-0.269 *	0.01	-0.265 *	1.16	1.24	0.31	PLS
EXPA	-0.169 **	1.063 ***	0.046	5.19 ***	28.90 ***	56.67 ***	FEM
PATA	0.053 ***	-0.299 ***	-0.006	5.35 ***	-29.61 ***	68.63 ***	FEM
REPA	-0.173 **	0.865 ***	0.259	6.05 ***	-17.84 ***	6.10 **	FEM
LIQ	-11.053 **	0.767	-10.774	1.30	0.51	1.45	PLS
LITA	0.073 *	0.021	0.056	5.75 ***	1.05	147.30 ***	PLS

Note: 1) *) Significant at $\alpha = 10\%$

**) Significant at $\alpha = 5\%$

***) Significant at $\alpha = 1\%$

2) PLS : Pooled Least Squared; FEM : Fixed Effect Model; REM : Random Effect Model

$\alpha = 5\%$. By adding the variables FSI (1) and TAGR (1) the parametric test (pooled least square), LITA aspect obtains statistical value of 0.073 with $\alpha = 10\%$. These results show there are real differences between LITA ratio of finance companies owned by shareholders with related value chain business and unrelated shareholders. LITA ratio of finance companies owned by related shareholders is greater than that of finance companies with unrelated shareholders. Related finance companies have a greater debt to equity allocation compared to unrelated finance companies.

Asset Quality Ratio

No significant differences were found for the risk ratio of finance companies owned by related and unrelated shareholders. Both type of firms have the similar policy on asset quality management.

Firm Size Ratio

With Mann Whitney test (MW) as shown in table 1, FSI (firm size) obtains a statistical value of -1.726 and is significant at $\alpha = 10\%$. With parametric testing (pooled least squares), FSI obtains a statistical value of 0.399 with $\alpha = 1\%$. These results show there are real differences between FSI ratio of finance companies owned by shareholders with related value chain business and unrelated shareholders. FSI

ratio of finance companies owned by related shareholders is bigger than that of finance companies with unrelated shareholders. Related finance companies have greater total assets than unrelated finance companies. FSI shows total assets of a finance company.

Liquidity Ratio

With Mann Whitney test (MW), LIQ obtains a statistical value of -2.165 and is significant at $\alpha = 5\%$. With parametric testing (pooled least square), LIQ aspect obtains statistical value of -11.68 with $\alpha = 1\%$. By adding the variables FSI (1) and TAGR (1) on the parametric test (pooled least square), LIQ aspect obtains statistical value of 11.053 with $\alpha = 5\%$. These results show there are real differences between LIQ ratio of finance companies owned by shareholders with related value chain business and unrelated shareholders. LIQ ratio of finance companies owned by related shareholders is smaller than that of finance companies with unrelated shareholders. Related finance companies have a smaller liquidity reserve compared to unrelated finance companies.

Profitability Ratio

No significant differences were found for the profitability ratio of finance companies owned by related and unrelated shareholders.

4. CONCLUSION

This paper investigates whether foreign shareholder influences the performance of finance company. Using a sample of 100 finance companies that published their financial statement over the period 2001-2015, we analyse whether foreign parent company's value are reflected in improved performance of the finance company subsidiary (measured using standard accounting ratios).

Our study produced several interesting findings. First, foreign acquisition and ownership with related industry reached efficiency, bigger firm size and better capital structure with lower liabilities. However, it also has lower revenue per asset and lower liquidity ratio. Overall, the result of the study indicate that the foreign acquisition and ownership will add value in the firm size, profitability and efficiency of target companies in Indonesia financial services industry.

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