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Operating performance following corporate acquisitions: Does the organisational form of the target matter?

Syed M.M. Shams [a], Abeyratna Gunasekarage [b,*]

[a] Faculty of Business, Economics, Law and Arts, School of Commerce, University of Southern Queensland, Brisbane, Australia
[b] Department of Banking and Finance, Monash Business School, Monash University, Melbourne, Australia

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ABSTRACT

We compare the long-run operating performance of private target acquirers and public target acquirers using a sample of Australian acquisitions. While private target acquirers realise significantly higher abnormal returns during the announcement period of acquisitions than public target acquirers, there is no significant difference in their operating performance during the post-acquisition period. Relative size has differential effects on the performance of two types of acquirers. Significant performance improvements are possible when private target acquirers make relatively large acquisitions and when public target acquirers acquire relatively small acquisitions. Acquisitions of private targets are also associated with significant performance improvements if they are undertaken by experienced acquirers.

1. Introduction

Various studies conducted across many markets have reported that private target acquisition announcements are associated with significantly higher abnormal returns than public target acquisition announcements (see Ang and Kohers, 2001; Chang, 1998; da Silva Rosa et al., 2004; Draper and Paudyal, 2006; Faccio et al., 2006; Fuller et al., 2002; Shams et al., 2013). The implication is that the capital market perceives private target acquisitions as more value-enhancing than public target acquisitions. However, Hitt et al. (1998) claim that the short-run market performance may not fully capture the long-term benefits associated with acquisitions. We are therefore motivated to investigate whether the difference in market perceptions, if any, is also reflected in the long-run operating performance of acquirers of private versus public targets. We investigate this issue using a large sample of Australian acquisitions.

Consistent with prior studies, our findings reveal that private target acquirers realise statistically significant positive abnormal returns during the announcement period of acquisitions while public target acquirers realise normal returns. However, this difference in market perceptions is not reflected in the long-run operating performance of acquirers. The results suggest that the post-acquisition operating performance of the former group is not significantly different from that of the latter group. The relative size plays a mediating role on the operating performance of two types of acquirers; performance improvements are possible only when private target acquirers make high relative size acquisitions and public target acquirers make low relative size acquisitions. Further, prior acquisition experience of private target acquirers has a positive influence on their long-run operating performance.

* Corresponding author. Department of Banking and Finance, Monash Business School, Monash University, Melbourne, Australia. Tel.: +61 3 9904 7249; fax: +61399047065.
E-mail address: abeyratna.gunasekarage@monash.edu (A. Gunasekarage).

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The findings of our study contribute to the existing literature in several ways. First, this is the first study to compare the long-run operating performance of firms that acquire public and private targets in a comprehensive fashion. Most prior studies have adopted a short-term perspective in investigating the market's assessment of the anticipated benefits of acquiring private targets (see, for example, Humphery-Jenner and Powell, 2011; Officer, 2007; Officer et al., 2009; Shams et al., 2013).[1] In addition, the evidence on the long-run performance of public target acquirers remains inconclusive (Martynova et al., 2006).[2] In this context, a comparison of the long-run operating performance between these two groups of acquirers will be a significant contribution to the literature. Second, Australia provides a suitable environment to examine these issues. Like the USA and the UK, Australia has a very active market for private target acquisition, thereby facilitating a large sample for testing. For example, during the 14-year period from 2000 to 2013, the Thomson Reuters SDC Platinum Mergers and Acquisitions database (SDC Platinum database hereafter) reported 3647 announcements of completed private target acquisitions by listed bidders while reporting a smaller number of 1268 announcements of completed public target acquisitions. In addition, the Australian private target market exhibits advantageous features, such as low regulatory cost and limited competition (Shams et al., 2013). Third, we use two unique samples in which public and private target acquirers have not acquired a target of the opposite organisational form during the three-year post-acquisition period. Finally, we employ a robust matching procedure whereby the benchmark firms selected have not merged with or acquired another company during the period of the data analysis. This enables strong inferences to be made from our empirical testing.

The remainder of the paper proceeds as follows. Section 2 discusses the relevant literature. The sample selection and data collection procedures are described in Section 3. Section 4 and Section 5 outline the methodology and discuss the findings respectively. Concluding remarks are made in Section 6.

2. Literature review

According to Draper and Paudyal's (2006) managerial motives hypothesis, decisions to acquire small private firms less well-known by investors are more likely to be associated with a strong motivation to enhance shareholder wealth. By contrast, decisions to acquire large and well-known public targets can be associated with an attempt to increase firm size and prestige. Indeed, the literature suggests that executives in large, diversified firms with complex organisational structures often seek to accumulate power and prestige rather than create investor value (Agarwal, 1981; Jensen, 1986; Kostiuk, 1990; Mahoney, 1979). Fuller et al. (2002) propose the liquidity hypothesis, whereby privately held firms cannot be bought and sold as easily as publicly traded firms. As a consequence, bidders can usually acquire such targets at a discounted price. Koeplin et al. (2000) state that domestic (foreign) private companies are acquired at an average discount of 20–30% (40–50%) relative to similar public companies. Officer (2007) states that acquirers generally pay substantially less for illiquid unlisted targets.[3]

Public targets are often large business entities, while private firms are small entities. This is reflected in substantial differences in average deal values offered to the two types of targets by bidders. For example, the SDC Platinum database reports that for the period 2000 to 2013, the average deal values paid in completed acquisitions by US, UK and Australian public target bidders were US$1524.77 million, US$2575.04 million and US$614.52 million, respectively, while the average deal values paid for the private targets were US$91.28 million, US$25.02 million and US$23.97 million, respectively. The acquisitions of large public firms by large public bidders may not necessarily create value as they can be motivated by managerial hubris (Moeller et al., 2004). Loughran and Vijh Anand (1997) and Ramaswamy and Waegelein (2003) show that acquirers of relatively large public targets perform poorly in the post-merger period.

The above phenomenon may not be applicable to acquisitions of private targets for several reasons. First, being small entities, private target acquirers employ special levels of care in the acquisition process when executing potentially risky and relatively large bids as such acquisitions have a relatively large economic impact on their companies (Moeller et al., 2004). Second, if the acquisitions of private targets are motivated by enhancing shareholder wealth (i.e. managerial motives hypothesis), agency problems should be less prevalent in such investment decisions, thereby resulting in a positive relation between the transaction size and the acquirers' wealth gain (Kohers, 2004). Third, small private targets may fail to generate

[1] One exception is Rahman and Limmack's (2004) Malaysian study. They collected the necessary data for both public bidders and private targets from financial statements and compared the post-acquisition cash flow performance of the merged firm with the pre-acquisition aggregate cash flow performance of the bidder and the target. They reported that the median control firm-adjusted cash flow performance increased from an average of 0.12% in the four-year pre-acquisition period (–4 to –1 years) to an average of 2.95% in the five-year post-acquisition period (+1 to +5 years).

[2] These findings can be categorised into three groupings: (i) a significant improvement (see Ben et al., 2008; Carline et al., 2009; Cosh et al., 2006; Fowler and Schmidt, 1989; Guest et al., 2010; Healy et al., 1992; Herman and Lowenstein, 1988; Heron and Lie, 2002; Ikeda, 1983; Kruse et al., 2002; Linn and Switzer, 2001; Martynova et al., 2006; Parrino and Harris, 1999; Powell and Stark, 2005; Rahman and Limmack, 2004; Switzer, 1996), (ii) a significant decline (see André et al., 2004; Clark and Ofek, 1994; Dickerson et al., 1997; Meeks, 1977; Sharma and Ho, 2002; Yeh and Hoshino, 2000, 2002) and (iii) no improvement (see Chatterjee, 2000; Dutta and Jog, 2009; Ghosh, 2001; Gugler et al., 2003) in the post-acquisition operating performance of bidding firms.

[3] A contrary view is that bidders may pay high premiums to acquire private targets due to the difficulty in finding listed benchmark firms for them because of the lack of financial data for private targets and ambiguity regarding their market values (Madura and Susnjara, 2013). The authors find that private targets are valued by acquirers at a 35% to 68% premium compared to public targets. If this phenomenon exists, private target acquirers should underperform compared to public target acquirers in the long-run as these excessive premiums could eliminate the benefits of synergy associated with such acquisitions.