Journal of Corporate Finance 26 (2014) 57–77

Contents lists available at ScienceDirect

Journal of Corporate Finance

journal homepage: www.elsevier.com/locate/jcorpfin

Firm size, sovereign governance, and value creation: Evidence from the acquirer size effect☆

Mark Humphery-Jenner [a,*], Ronan Powell [b,1]

[a] Australian School of Business, UNSW, Sydney, NSW 2052, Australia
[b] DCU Business School, Dublin City University, Glasnevin, Dublin 9, Ireland

A R T I C L E I N F O

Article history:
Received 28 September 2013
Received in revised form 7 February 2014
Accepted 26 February 2014
Available online 7 March 2014

JEL classification:
G34
G38
K22
K23

Keywords:
Governance
Regulation
Takeovers
Size-effect

A B S T R A C T

This paper examines the relationship between acquirer size, sovereign governance, and value-creation in acquisitions. Prior literature indicates that larger acquirers' acquisitions create less shareholder wealth in developed markets, arising primarily from agency and entrenchment problems. However, in weak governance environments, size might have off-setting benefits, including increased market power and political connections. We use a sample of 17,647 takeovers from 45 countries to examine the acquirer size effect around the world. We find that the acquirer size effect exists internationally, but is smaller in magnitude in weak governance markets. Compared with larger acquirers in strong governance countries, large acquirers in weak governance countries do takeovers that generate higher stock-returns and increase post-takeover operating performance. Their deals are also more likely to be friendly, and take less time to complete. We also find that the benefits of larger acquirer size increase with the importance of political connections in the acquirer's country. The results suggest that country-governance can moderate the impact of corporate characteristics, such as corporate size.

© 2014 Elsevier B.V. All rights reserved.

1. Introduction

This paper examines the relationship between country-governance and the size-effect in acquisitions. Prior literature shows that larger acquirers tend to earn lower acquisition-returns in strong-governance countries (Moeller et al., 2004). The argued reason for this finding is that large size can insulate managers from the market for corporate control, leading to managerial entrenchment and value-destruction. However, larger firms could experience several advantages in weaker governance markets. One view is that political connections and market power can be valuable sources of shareholder wealth in weak governance markets. This is largely due to weak governance countries having weak institutions and property rights, with key players, including politicians, wielding significant power without much accountability (Fisman, 2001; Johnson and Mitton, 2003). Such political connections are more likely to exist in large, powerful companies (Farina, 2002), who are better able to exploit these advantages to increase shareholder wealth. Another view, but one with similar valuation outcomes for shareholders, is that in weak governance countries, larger size serves to protect firms from

☆ This paper benefited from comments received at seminars at the UNSW and University of Technology Sydney, and at the Financial Management Association Annual Meeting (2012) and Financial Markets and Corporate Governance Conference (2013). We also thank Jeff Netter, an anonymous reviewer, Dirk Baur, Doug Foster, Jack He, Praveen Kumar, Shawn Mobbs, Marco Navone, Pascal Nguyen, Talis Putnins, Michael Skully, Eliza Wu, and Ke Yang. Humphery-Jenner thanks the Australian Research Council (ARC project number DP140103039) for financial support.

* Corresponding author. Tel.: +61 2 9385 1000.
E-mail addresses: mlhj@unsw.edu.au (M. Humphery-Jenner), ronan.powell@dcu.ie (R. Powell).
[1] Tel.: +353 1 700 5000.

http://dx.doi.org/10.1016/j.jcorpfin.2014.02.009
0929-1199/© 2014 Elsevier B.V. All rights reserved.

possible expropriation and government corruption. Under this view, firms have incentives to increase in size over time as a means of adapting to their environment (Granovetter, 1995; Guiso and Rustichini, 2011; Khanna and Yafeh, 2007; Lucas, 1978).

In well-governed and regulated markets, companies are better protected from sovereign rent-seeking and expropriation, so larger size is likely to be less valuable in protecting shareholder wealth. Indeed, the economics and finance literature has generally focused on large size as a source of value destruction and agency conflicts in well-governed open economies (Baumol, 1962; Jensen, 1986). For example, in analyzing takeover returns, Moeller et al. (2004) report average losses of $25 million for large acquiring firms in the USA over the period 1980–2001. Further, Moeller et al. (2005) show that a relatively small number of large firms account for takeover losses of over $240 billion during the period 1998–2001. The scale of the shareholder value-destruction through takeovers by large firms is interesting given that the USA is one of the most highly rated countries on a range of governance metrics, including the International Country Risk Guide (ICRG) and the World Bank (WB). One of the explanations given for such an effect is that in a strong governance country, such as the USA, firm size serves to entrench managers from external discipline from the market for corporate control (c.f. Offenberg, 2009). Noteworthy, however, is that while the losses experienced by large acquiring firms in the USA are well documented, there is a dearth of evidence on the comparative value-implications of corporate size in an international context.

This paper examines whether and why the acquirer size effect in acquisitions varies with the governance of the acquirer's country. Our main empirical investigation begins with an examination of the relation between acquisition returns and the interaction of firm size with sovereign governance indices across our sample of 45 countries. We show that large acquiring firms tend to earn lower acquisition returns than do smaller acquiring firms, consistent with the presence of agency conflicts and managerial entrenchment. However, compared with large acquirers in strong governance countries, large acquirers in weak governance countries perform significantly better, even after controlling for a range of firm, industry, country, and time-specific factors. We hypothesize that this is because while large firms in weak governance countries may still suffer from agency conflicts related to managerial entrenchment, the benefits of large size in those countries may at least partially off-set agency-related costs.

We next explore several of the value-drivers in large-firms' acquisitions. We provide some evidence suggesting that there are fewer barriers to completing takeovers by larger acquirers in weak governance countries: their deals take significantly less time to complete (controlling for other factors), than those of large acquirers in strong governance countries. Furthermore, whereas larger acquirers (compared to smaller) in stronger governance countries are more likely to be involved in costly hostile takeovers, we find that for weaker governance countries, larger size actually increases the likelihood of doing a friendly deal, which we know from our analysis, is significantly more value-enhancing. Our analysis of takeover premiums provides no evidence that the benefits of large size merely reflect expropriation from the target firm's shareholders (as opposed to actual value-creation). Further, large firms in weak governance markets do takeovers that are more likely to increase operating performance than are their counterparts in strong governance markets.

We also provide some additional evidence to support the view that political connections are an important value driver for larger firms in weak governance countries. We use political connection data from Faccio (2006) to examine the importance of corporate size in countries where corporate-political connections appear to be especially prevalent. We find that the benefits of large size increase significantly with the importance of political connections in a given country, implying that larger firms' deals might benefit from their connections, or at least their ability to navigate environments where connections and political issues are especially important. We also confirm this by examining sub-samples of deals (i.e. domestic deals and diversifying deals) where political connections are most likely to be important.

The results contribute to the takeover and the corporate organization literature by shedding new light on the size-effect in acquisitions. We find evidence of a size-effect in acquirer returns that extends internationally, supporting the argument that agency and managerial entrenchment costs increase with firm size. However, large acquirers in weak governance countries perform significantly better (or at least less poorly) than do large acquirers in strong governance countries. This suggests that large firms in weak governance countries enjoy some advantages, which at least partially off-set the agency-cost implications of corporate size. We provide some evidence that political connections can help to off-set the agency-related factors that are associated with large size. We also conduct a number of robustness tests, including using different definitions of firm size and measures of abnormal returns, and confirm that our results are robust to model specification issues. We also control for some other potential sources of heterogeneity that may explain our results, including controls for firm-level governance, and the quality of target country governance on takeover returns. We find that our results continue to hold in these robustness tests.

The outline of this paper is as follows. Section 2 discusses the prior literature and develops the hypotheses. Section 3 presents the data and defines the variables. Section 4 contains the empirical analysis of the impact acquirer size on acquisition performance. This section also discusses several robustness tests. Section 5 concludes.

2. Hypothesis development

Takeovers are an event in which an acquirer might benefit from being a larger firm in a weak governance environment. Corporations in weak governance environments can generate value by extracting rents from the government (Chen, 2013; Fisman, 2001), and by exploiting their market power to extract rents from other market participants. Larger and 'more powerful' companies are usually more politically connected (Faccio et al., 2006) and have greater market power, allowing them to extract higher rents. Strong governance is one way to reduce rents from the government (Faccio, 2006) or from market power (Khanna and Palepu, 2000). For several reasons, this would suggest that larger firms in weak governance environments enjoy several benefits that would at least partially off-set the agency-cost implications of corporate size.

Download English Version:

https://daneshyari.com/en/article/5093459

Download Persian Version:

https://daneshyari.com/article/5093459

Daneshyari.com