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Conference calls around merger and acquisition announcements: Do they reduce information asymmetry? UK Evidence

Georgia Siougle, Spyros I. Spyrou, Andrianos E. Tsekrekos*

Athens University of Economics and Business (AUEB), Department of Accounting and Finance, 76 Patision str. , GR10434 Athens, Greece

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ABSTRACT

This paper examines conference call meetings held around merger and acquisition (M&A) announcements in the UK market. Our main findings indicate that conference calls not only facilitate the smoother transmission of M&A-related information in the stock market and smooth the rate of the information flow to the market, but also they reduce informed trading through option markets before M&A events. We also find that there is an inverse relation of analysts' forecast error and conference call probability, that firms initiate conference calls during M&As when their transactions are large and are facing liquidity constraints, and that the probability of a firm holding a conference call around an M&A is strongly and inversely related to the existence of traded equity options on its stock.

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1. Introduction

The efficient allocation of resources is a key driver of wealth accumulation and economic growth. However, incentive misalignments (Jensen and Meckling, 1976) and information problems (Akerlof, 1970) hinder this allocation between corporations and stakeholders (Healy and Palepu, 2001). Regulated and voluntary disclosure by corporations (as well as institutions like auditors and rating agencies

* Corresponding author. Tel.: +30 210 8203928; fax: +30 210 8203928.
E-mail address: tsekrekos@aueb.gr (A.E. Tsekrekos).

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that establish or rate disclosure credibility) facilitates the mitigation of these problems and misalignments.

Firms regularly and/or voluntarily disclose value-relevant information to stakeholders through a number of alternative means: regulatory financial statements, management forecasts, conference call meetings, sustainability or corporate social responsibility (CSR) reporting, press releases, etc. Prior research has examined both financial (see for example Healy and Palepu, 2001; Core, 2001) and non-financial voluntary disclosure (e.g. Orlitzky et al., 2003; Al-Tuwaijri et al., 2004; Dhaliwal et al., 2011). The consensus seems to be that voluntary disclosure is positively perceived by investors, as greater (financial and/or nonfinancial) disclosure increases the awareness of investors regarding firm performance and sustainability and leads to reduced information asymmetry between the firm's investor base and management.

This positive perception by investors, and the reduced information asymmetry that is associated with voluntary disclosure, should be of great interest to managers, especially those that expect their firms to transact in the capital markets soon or frequently. Less asymmetry in firm-specific information and higher disclosure quality reduce the firm's cost of capital (Merton, 1987) and improve credit ratings (Aman and Nguyen, 2013) and risk-sharing by making investors more willing to trade the firm's securities (Verrecchia, 2001).

This paper contributes to the literature on corporate disclosure by examining voluntary disclosure of information related to unscheduled capital market transactions by UK listed corporations. More specifically, we examine whether conference call meetings (held by firms listed in the London stock exchange) reduce the information asymmetry that is associated with the announcement of merger and acquisition (M&A) deals in which these firms are involved as target, buyer or merging partner.

Conference calls are widely employed by firms as a means of voluntary information disclosure and are assumed to reduce asymmetries in information (Brown et al., 2004). We first study stock returns and stock trading volume around the M&A announcement by UK firms that initiate a conference call and firms that do not, in order to investigate whether conference calls affect announcement returns and trading volume.

Secondly, we examine whether the existence of equity options affects investor behavior around M&A announcements that are associated with a conference call meeting. This examination is motivated by the fact that empirical studies (e.g. Cao et al., 2005 among others) have established that when a firm has both options and stocks available for trading, options displace information (that could otherwise be reflected in stock imbalances) in the period immediately preceding a major corporate announcement.

In line with our hypothesis on the effect of traded equity options, we find that the information asymmetry reduction achieved by conference call meetings around M&A announcements is more limited when the announcing firm has options traded on its common shares. Firms without equity options should be more willing to hold conference call meetings, as an alternative means of diffusing M&A related information to the marketplace. To the best of our knowledge, the notion that conference calls contribute more to reductions in information asymmetry in the absence of traded option contracts has not been examined or documented before in the literature, and it has important implications for the willingness of managers to hold conference call meetings as a means of voluntarily disclosing financial information.

The rest of the study is organised as follows: In the next section we present in more detail the theoretical underpinnings of our empirical investigation and elaborate further on the contribution this study makes to the existing literature on voluntary disclosure. Section 3 describes the data used in our investigation. Sections 4 and 5 examine the effect that conference call meetings, held around M&A announcements, have on firm abnormal stock returns and abnormal stock volumes respectively. In Section 6 we investigate the role of options while in Section 7 we examine which firms opt for a conference call. Section 8 concludes the paper.

2. Related literature and motivation

Research on voluntary disclosure is based on the assumption that managers have superior information to outside investors and stakeholders regarding the future prospects of firms (Myers and Majluf,

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