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Do cross-border and domestic bidding firms perform differently? New evidence from continental Europe and the UK

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ABSTRACT

In this paper we investigate the main features of the domestic and cross-border corporate acquisitions involving 38 European countries in the period 2003–2010. The analysis is based on characteristics of takeover transactions such as type of transaction, payment method, legal status of the target firm, activity relatedness, amongst other factors. In addition, we investigate the short-term wealth effects of 2821 European mergers and acquisitions initiated by large and medium-sized European firms. We find that, upon announcement, domestic acquiring firms earn higher abnormal returns than cross-border bidders. Domestic bidders' outperformance holds even when controlling for different bid and firm characteristics such as method of payment, type of transaction, public status of the target firm, and activity relatedness of the target and the bidder. We find larger short-term wealth effect of foreign firms bidding on Continental European targets than those of foreign firms acquiring companies in the UK/Ireland. Our analysis shows that cross-border bidding firms tend to experience lower announcement returns when targets are located in countries with stronger investor protection mechanisms, suggesting that acquirers must compensate target firm shareholders (that is, pay higher premiums) if the quality of the corporate governance is reduced.

1. Introduction

Increased level of mergers and acquisitions (M&As) is one of the most important developments in corporate finance in the last few decades. Through a merger or acquisition economies of scale, access to new geographic regions and new technologies can be obtained. However, the failure of such an event, either before or after its completion, can be very harmful for a company. The main motives for companies to engage in M&A activities are synergies and the correction of mistakes made by management (Martynova and Renneboog, 2006). Synergies in corporate takeovers are expected to occur in operations and financing. Operating synergies result mainly from economies of scale, a decrease in agency cost, and a knowledge or skill transfer (Ravenscraft and Scherer, 1989). Merging companies from related industries tend to have mostly operational synergies (Comment and Jarrell, 1995). Financial synergies on the other hand usually arise from diversifying

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deals (Martynova and Renneboog, 2006). A decreased probability of bankruptcy, more stable cash flows and easier access to capital are different forms of financial synergies (Higgins and Schall, 1975; Lewellen, 1971; Stein, 1997).

Typically researchers use event studies to measure the impact of corporate transactions on either short- or long-term shareholder value, where the former measures initial market reaction, that is, changes in share price over a short time period around the announcement of a deal (usually one month prior to and one month after transaction announcement), while the latter analyzes relative returns over a longer period, often one, two or three years after the transaction announcement. The benefits of using a shorter time frame are that there is less risk of additional factors, or events, affecting the share price of the company in question. The extensive academic literature that focuses on this time frame finds that the returns of targets are positive as a result of transaction announcements. Conceptually, this abnormal positive performance probably reflects the premium that is offered in most transactions, in order to entice the existing shareholders to accept the offer.

Over the longer-term, and assuming that both companies are publicly traded companies, the combined share price of the acquirer and the target should reflect a truer representation of the economic value of any deal. Several studies have examined the longer-term shareholder performance of the acquirer. Sudarsanam and Mahate (2006) find evidence that hostile bids provide superior value creation three years post-acquisition compared to friendly bids, but also that acquirers of all types suffer negative long-term (adjusted) returns. Following the methodology presented by Moeller et al. (2005), which measures monetary gain around the announcement, Clare and Faelten (2012) find that transactions in the UK have added, on average, £87 million of above benchmark gains per deal, albeit a statistically insignificant creation of wealth. Although over the long-term period M&A transactions generate on average an adjusted return of 7.18% to the acquirers' shareholders, these returns are largely driven by the initial short-term gains in the period surrounding the announcement of a transaction[1].

The bulk of previous research on M&A activity is confined to the US and UK markets while the pattern of M&A activity in Continental Europe remains relatively unexplored. Numerous authors (La Porta et al., 1998; Faccio and Lang, 2002) have pointed out that accounting standards are better and investor protection is stronger in an Anglo-Saxon setting, while concentrated ownership is more widespread in Continental Europe where many listed companies are controlled by families. Similarly, Martynova and Renneboog (2008) argue that English legal origin countries provide the highest quality of shareholder protection. The analysis presented in this study emphasizes the potential differences in Anglo-American markets for corporate control and Continental European ones[2].

The principle goal of this paper is to examine the motivation behind domestic and cross-border acquisitions of European firms in the period 2003–2010. We investigate the short-term wealth effects of 2821 European mergers and acquisitions initiated by large and medium-sized European firms. Previous research (Martynova and Renneboog, 2006; Craninckx and Huyghebaert, 2013) reports a significant difference in abnormal returns to bidders and targets depending on their location—Continental Europe or the UK. We further explore this issue by examining the impact of domestic and cross-border acquisitions on European bidding firms in Continental Europe and the UK/Ireland. More specifically, we address the question of whether European bidders are able to profit more from acquisitions in Continental Europe than in the UK or Ireland. The empirical literature on M&As argues that national differences in country governance characteristics may have significant impact on the short-term wealth effect of cross-border acquisitions. We test this hypothesis by investigating whether the differences between cross-border and domestic acquisitions are related to differences in corporate governance system of the bidder and the target's home countries or differences in bid and firm characteristics.

There are several important contributions of this study. First, most of the empirical research so far concentrates on the US and UK takeover markets with less attention to Continental European bidders and targets. We investigate the short-term wealth effects of a large sample of European mergers and acquisitions and find that, upon announcement, domestic acquiring firms earn higher abnormal returns than cross-border bidders. Domestic bidders' outperformance holds even when controlling for different bid and firm characteristics such as type of transaction, public status of the target firm, and activity relatedness of the target and the bidder. This result is in line with Martynova and Renneboog (2006) who also find that bidding firms engaging in cross-border bids experience *lower* announcement effects than those undertaking domestic acquisitions (0.4% versus 0.6%, respectively), the difference of which is statistically significant[3]. However, the premiums paid to targets depend on the location of the target firm. Our study brings new evidence on this puzzling issue. We find that the short-term wealth effects of foreign firms bidding on Continental European targets are larger than those of foreign firms acquiring companies in the UK/Ireland.

Second, prior research reports that both target and bidding firm shareholders gain significantly more in cash than in equity offers. For example, Martynova and Renneboog (2006) find that all-cash offers as well as bids combining cash, equity and loan notes trigger substantially higher abnormal returns (respectively, 12% and 10% at the announcement) than all-equity bids

[1] In a recent study of 389 partially-acquired firms in domestic and cross-border acquisitions across South and East Asian markets, Dang and Henry (2015) find that both domestic-acquired firms and cross-border acquired firms do not experience significant gains in the stock prices before and after the takeovers, though they achieve positive abnormal returns around the acquisition announcement.

[2] While the main engine of takeover activity in Europe during the 1990s was still the UK, M&As in Continental Europe have risen substantially both in number of deals and total transaction value compared to the previous decades. The fifth wave in Europe was impressive in monetary terms as well, since its total value adds up to US$ 5.6 trillion (Martynova and Renneboog, 2006), more than eight times the combined total of the fourth European merger wave (1983–1989). One third of all intra-European M&As during the period of 1993–2001 were cross-border deals.

[3] In contrast, Tebourbi (2005) and Danbolt and Maciver (2012) in their studies on Canadian and UK bidders, respectively, find that the overall wealth creation is higher in cross-border than in domestic acquisitions, although the gains generally accrue to target rather than to bidding company's shareholders.