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Value creation by block acquisitions and the importance of block owner identity[☆]

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ABSTRACT

We examine stock price reactions to minority block purchases in German target companies. Our results document that the formation of new outside blocks leads to significant value creation for target shareholders, the size of the effect depending on the identity of the block acquirer. As blocks by strategic investors or activist sponsors entail significantly higher returns compared to pure financial block acquirers this result can be ascribed to a differentiated support of the monitoring hypothesis of agency theory. We also find a negative relation between target firms' growth before the acquisition and the value generation by new block owners.

1. Introduction

Recent research underlines that not only the ownership concentration but also the identity of concentrated ownership plays an important role in explaining the success of acquisitions (Craninckx and Huyghebaert, 2015). The more actively a block owner is engaged in monitoring the management board of an acquired company, the more beneficial the role of the block owner appears (Mietzner and Schweizer, 2014). However, the benefits from active monitoring also depend on the overall institutional setting. Humphrey-Jenner and Powell (2014) show that the acquirers' monitoring effect is strongest in weak governance countries. Likewise, the overall influence of large block owners beyond their role in corporate acquisitions may also depend on the size of their holdings and on their identity (Chauhan et al., 2015; Mietzner and Schweizer, 2014; Konijn et al., 2011; Ruiz-Mallorquí and Santana-Martín, 2011). Our study investigates the overall level of value creation by block transactions in the comparably weak governance system of Germany and takes a special focus on divergences in value creation by three different groups of investors namely strategic, activist and financial acquirers.

Our results show that strategic and activist block acquisitions exhibit large positive valuation effects of more than 8%, which are significantly higher than those of financial block purchases. The value generation is increasing in block size

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which is in line with a stronger commitment to monitor by the new block owner depending on his financial stake. We also find a negative relation between target firms' growth before the acquisition and the value generation by new block owners. Furthermore, there is a positive relation between leverage and cross-border transactions. These findings contribute to the literature on shareholder wealth effects subsequent to announcements of block acquisitions and enhances the understanding on ambiguous results regarding the identity of blockholders and their effect on corporate governance and firm value (see, e.g., Cronqvist and Fahlenbrach, 2009; Boubakri and Ghouma, 2010; Konijn et al., 2011; Ruiz-Mallorquí and Santana-Martín, 2011; Mietzner et al., 2015). Moreover, our findings extend the understanding on minority block purchases in weak corporate governance systems like Germany and complement the results of Achleitner et al. (2011), Drees et al. (2013) and Puche et al. (2015).

2. Hypotheses development

Chauhan et al. (2015) classify it as common opinion shared by practitioners and academics that block owners may reduce agency problems. In line with this opinion, a number of studies in the last three decades provide empirical evidence on positive capital market reactions to the announcement of a new block acquisition. The theoretical foundation of this evidence lies in the monitoring hypothesis of agency theory. If new block owners indeed are to effective monitors, then their presence should be accompanied by sustainable positive stock returns of the target firms. These returns should increase with the size of the acquired block as a larger financial stake can be interpreted as a stronger commitment to monitor the firm. Consequently, we expect to find significant stock price increases in the short-run following the announcement of block transactions and block size to be a significant explanatory factor for the wealth effect.

Puche et al. (2015) show that the relative value creation of private equity transactions is generally larger in Europe compared to the US, once results are controlled for leverage. As an explanation, Puche et al. argue that the North American market is large and its participants are sophisticated. If this outcome is true not only for activist investors, but for all kind of block acquirers, then we expect to find a higher value creation in case of cross-border block transactions in Germany.

The potential to provide effective monitoring and to generate additional shareholder value will typically depend on the resources an investor is able to dedicate to the newly acquired company. Strategic investors interested in an expansion of their value chain and activist investors looking for targets where they can improve management quality and generate additional growth can usually provide more support to their new portfolio firms than financial block purchasers with limited personnel resources. Therefore, we expect to find different announcement returns depending on the identity of the new block owner with higher effects for activist and strategic acquirers compared to financial blockholders.

If strategic and activist investors are interested in actively supporting the target firm's management in creating additional shareholder value, then the market reactions are expected to be higher for target firms with high potential for improvements. Companies with low growth in sales and low returns on assets usually offer significant potential for performance increases. We therefore expect to find negative effects of past sales growth and return on assets to the value creation by new blockholders. By contrast, we expect to find higher value creation for companies with poor past performance. The market-to-book ratio as an alternative measure of growth options and market performance is expected to be less significant as this variable can also express asset specialization (Oler, 2015), which in turn might limit the potential for value generation.

The ownership structure before the block acquisition might also influence the value generation potential of new block acquirers. A concentrated ownership with at least one dominant shareholder that possesses a significant and stable stake is prevalent in German corporations (Mietzner and Schweizer, 2014; Franks and Myers, 2001; La Porta et al., 1999). This concentrated ownership can enhance firm value, if the blockholder solves agency problems that arise from the separation of ownership and control (see, e.g., Shleifer and Vishny, 1986; Maug, 1998), blockholders may try to expropriate rents from other stakeholders (Shleifer and Vishny, 1997). This agency conflict between majority block owners and minority shareholders can be attenuated by a second large blockholder. Therefore we expect to find positive value generation by new blockholders independently from the already existing shareholder structure.

Overall the effect of additional monitoring should be sustainable with not only a positive announcement return for the acquisition targets but also a positive long-run effect. Whether the acquirers are also able to profit from block acquisitions depends on the capital market expectations of their average performance. If a significant positive performance expectation is already priced in the acquirer's share price, no additional revaluation is expected. However, as most of the acquirers in our sample are not exchange-listed, an investigation of this effect is beyond the scope of our analysis.

3. Data and methodology

Relevant block purchases with German targets were identified using the SDC/Thomson One Banker Deal database. To allow for comparability with the results of Craninckx and Huyghebaert (2015), we choose the same sample period from 1997 to 2014. Following Choi (1991), we define outside minority blocks as investors who own more than 5% but less than 50% of the target's firm voting stocks after the purchase. In addition, we require the initial ownership to be 0%. Overall we use nine criteria to specify the sample:

(1) The acquired block size is 5–49.9%