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The determinants of failed takeovers in the banking sector: Deal or country characteristics? ☆

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ABSTRACT

The consolidation process which characterized the banking industry in the last decades has been widely analyzed, but very few studies have investigated the reasons which bring a number of announced deals to failure. We fill this gap in the literature analyzing the characteristics of failed M&A operations in a large sample, including all the major domestic and cross-border deals in the banking sector announced worldwide between 1992 and 2010. The results show that the most important factors which determine the failure of an announced operation are deal specific characteristics, in particular the hostility of the bidder and the presence of multiple potential acquirers. Moreover, lengthier negotiations have a lower probability of success. Contrary to expectations, cross-border operations are more likely to be successfully completed than domestic ones.

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1. Introduction

Corporate transactions have a critical role in market economies. The competition for corporate control is one of the main tools through which inefficient administrators can be removed and unprofitable companies can be reconverted. In the banking sector, the large wave of mergers and acquisitions (M&As) registered in the United States during the '80s (followed a little later in Europe, fostered by the II EU Directive on the Single Market) have increased the efficiency of the credit allocation mechanism significantly (Vander Vennet, 1996; Akhavein et al., 1997; Focarelli and Panetta, 2003). These consolidation processes have been studied extensively and there is now a broad consensus on the determinants of domestic and cross-border M&As: larger and more profitable banks typically acquire weaker financial intermediaries, with the aim to restructure and increase efficiency (Focarelli et al., 2002).[2]

Despite this large literature, there has been no analysis of the elements which determine the abandonment of announced deals. In general, the phenomenon of abandoned deals is not negligible. O'Sullivan and Wong (1998), for example, show that between 1989 and 1995 in the United Kingdom almost 20% of the publicly announced transactions among all types of firms have not been completed. Wong and O'Sullivan (2001) argue that the failure may depend on several factors: the intervention of regulatory authorities; the success of defensive strategies implemented by the management of the target company; the emergence of conditions which determine a volunteer withdrawal by the acquired company. The phenomenon is quantitatively relevant also among banks: on average, about 5% of the deals announced in the world are not completed, with peaks of over 10% in more financially

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[2] Reviews of the literature on bank mergers are provided by Amel et al. (2004) and DeYoung et al. (2009).

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advanced countries. Moreover, abandoned deals are among the most important (in our sample, the average value of transactions which are not successfully completed is more than twice that of the transactions successfully completed). However, to the best of your knowledge, analyses focusing specifically on the banking industry are still lacking.[3] A number of papers (e.g., Focarelli and Pozzolo, 2001; Pozzolo, 2009) have argued that the pervasive influence of information asymmetries (Morgan, 2002) and the stronger role of regulation authorities make the determinants and the pattern of M&As in the banking sector not fully comparable with those of operations among non-financial industries. All these reasons call for a specific analysis on what the determinants to abandon a M&As in the banking sector are.

To fill the gap in the literature, we study the characteristics of abandoned M&As in the banking sector using a sample of more than 20,000 domestic and cross-border operations, announced in over 150 countries around the world between 1992 and 2010. Building on the previous literature on abandoned deals in non-financial sectors, we focus our analysis on three sets of determinants: (i) deal specific characteristics, such as size, duration, method of payment and whether the operation is domestic or cross-border; (ii) features specific of the bidders and of the targets, such as size and leverage; and (iii) country specific characteristics, such as the development of the financial market, the severity of regulations.

We find that deal specific characteristics are by far the most important determinants for the abandonment of an announced deal. In particular, hostile operations, those involving more than a single potential acquirer and those requiring longer negotiations have a significantly lower probability of success. We also find that deals with targets incorporated in countries with stricter regulatory authorities and a more developed banking sector also have a lower probability of success, but in this case the impact is almost negligible. Finally, cross-border deals are more likely to be successful than domestic deals. This is contrary to our expectation that the presence of strong cultural differences, regulations, and other implicit and explicit barriers could determine a higher abandonment ratio in the case of international operations.

The rest of the paper is organized as follows. Section 2 sets the framework of our research, describing the results of the previous literature and the major hypotheses behind our empirical analysis. Section 3 describes the sources of the data and comments the major trends and Section 4 presents the econometric framework. The results of the econometric analysis are presented in Section 5. Section 6 concludes.

2. The determinants of the abandonment of announced M&As

The determinants and the effects of M&As in the banking sector have been extensively analyzed in the theoretical and empirical literature. In a nutshell, the available evidence shows that larger and more profitable banks acquire weaker banks with the aim to restructure them and increase their efficiency (Focarelli et al., 2002). However, acquirers typically register a drop in their stock prices at the moment of the announcement of the deal, especially in the case of diversifying and cross-border operations (DeLong, 2001).

Nevertheless, not all announced deals end up being completed, either because the parties involved do not find a satisfactory agreement or because the target of the operation successfully adopts defensive techniques, or finds an alternative acquirer. Understanding the reasons why some deals are abandoned permits to better assess the likelihood of a planned operation to succeed, reducing the costs of an announcement to the market followed by a withdrawal. In fact, organizing an M&A is very costly because of the required efforts for internal managers and external advisors to plan and organize the operation from an economic, financial and legal viewpoint. This typically requires large teams of highly skilled and highly remunerated professionals to work for months. From the target point of view, evaluating the offer, bargaining on the conditions of the deal and eventually organizing a defense can also be very expensive. This is why we also need evidence to allow them to forecast the likelihood of success of these defensive actions more accurately. In addition, once an operation is announced, its abandonment typically implies a strong negative reaction focused on the stock price of the bidder (Lorenz and Schiereck, 2007). This often leads to the removal of the management, and can in turn transform the bidder in a target of a possible acquisition (Franks and Mayer, 1996; Agrawal and Walkling, 1994).

Despite its practical importance, the theoretical and empirical literature on the determinants of M&A abandonments is rather limited. Specifically, as shown in the survey by Wong and O'Sullivan (2001), most of the available evidence studies large samples of M&A deals, treating operations in different sectors as if they were similar. Due to the higher number of M&A operations organized in the non-financial sector compared to the banking and financial sector, results tend to be driven mostly by the characteristics of non-financial firms, even when bank deals are included in the research sample. Specific features of M&A's in the banking sector, where information asymmetries and regulation are both more relevant, are thus normally overlooked. This, on the other hand, is the focus of our analysis.

In spite of the large number of M&As which took place among banks in the last decades, to the best of our knowledge the only study on abandoned deals in the banking sector is that by Lorenz and Schiereck (2007). In their analysis of 97 operations among European banks between 1996 and 2002, they show that failures are more likely when the bidder is small. This because it offers a high acquiring price and the announcement causes a significant drop in its stock price.

In the following, we attempt to complete the literature by presenting the results of an empirical analysis regarding the abandonment of announced M&As in the banking sector, based on a sample of more than 20,000 cases. The previous literature on the determinants of M&A's in the banking sector and the available evidence on failed takeovers, mostly in the manufacturing sector, suggests that many different features can determine the success of a bank M&A operation. These may range from deal and bank specific characteristics to the properties of the countries where the interested actors operate. In the following we will analyze each of them in detail, setting the theoretical background for our empirical analysis.

2.1. Characteristics of the deal

The most critical feature for the success of an M&A deal is the reaction of the managers of the target company: either friendly or hostile. For example, a relatively common practice which affects the probability of success of an M&A deal is the signing of an agreement between the bidder and the target, with some clauses to put a cost on the abandonment of the operation. This can be done by granting the potential acquirer a call option on the common shares (stock lockup) or on certain assets of the target (asset lockup). This can be applied in case the target merged with another buyer. In alternative, it is possible to grant a compensation in cash to one of the two parties if the operation is abandoned. Deals involving these types of agreements, known as lockup clauses, are obviously less likely to fail (Coates and Subramanian, 2000; Bates and

[3] An exception is the unpublished paper of Lorenz and Schiereck (2007) that we discuss in more detail below.

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