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Title: The Source of Financing in Mergers and Acquisitions

Author: id="aut0005" author-id="S1062976917300078-0072e9fd89440a70915f7c0c2c3b6e5c"> Mario Fischer

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The Source of Financing in Mergers & Acquisitions☆

Mario Fischer

Department of Financial Management and Capital Markets, TUM School of Management, Technische Universität München, Arcisstr. 21, 80333 Munich, Germany

Abstract

I directly focus on the source of financing in takeovers instead of the common but indirect approximation by the payment method. By examining a sample of 610 acquisitions occurring between 1991 and 2009, I am able to distinguish between several different sources of financing for sizeable transactions and to additionally control for any payment effect. For the initial decision if the takeover should be financed with internal funds, the completion time and the acquirer's pre-takeover characteristics (cash level, Tobin's Q, and leverage) are crucial. When deciding the source of external funds, the acquirer's pre-takeover cash level remains important, while the target's characteristics (nationality, listing, and competing bids) gain importance. For acquisitions that are more credit-financed, I find superior short-run performance; takeovers financed mainly with common stock issues yield poor announcement returns. Over the three years following an acquisition, my analysis reveals that capital markets efficiently price all information at the announcement; only takeovers financed with a common stock issue significantly underperform in subsequent years.

Keywords: Acquisition, Financing Source, Long-Run Performance, Merger, Payment Method, Short-Run Performance

1. Introduction

Even though there exists overwhelming empirical evidence suggesting that cash payment outperforms stock payment in takeovers, the economic rationale for this outperformance is still up for discussion.[1] This is rather shocking, as mergers and acquisitions are among the most influential decisions for companies – and finding a value-maximizing structure of the transaction should be crucial. So far, the (implied) academic assumption is that the payment method might be a valid approximation for the involved source of financing (for example, Faccio and Masulis, 2005; Harford, Klasa, and Walcott, 2009; Uysal, 2011; Karampatsas, Petmezas, and Travlos, 2014; Vermaelen and Xu, 2014). In this context, Schlingemann (2004) states that *the form of payment has been used as a proxy or substitute for the source of financing* (p. 684), and Martynova and Renneboog

☆Contact: mario.fischer@tum.de. This version: October 2016. JEL classifications: G14, G32, G34. The results of this paper are included in my PhD thesis at Technische Universität München. Part of the research was conducted during stays at Harvard and Yale University.

[1]The terms acquisition, merger, takeover, and transaction are used interchangeably in this study. The outperformance of cash payment is shown by Travlos (1987), Amihud, Lev, and Travlos (1990), Brown and Ryngaert (1991), Servaes (1991), Fuller, Netter, and Stegemoller (2002), and Faccio, McConnell, and Stolin (2006), among others.