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Mergers and acquisitions in Germany: 1981–2010

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ABSTRACT

We examine the long-term performance of German acquiring firms for M&A transactions that took place between 1981 and 2010. Over this period, the German corporate governance system experienced substantial changes that led to the emergence of an active M&A market. In contrast to many U.S. studies, we do not find significant negative abnormal long-term performance for our full sample. However, the results support the method-of-payment hypothesis. For our first subsample, from 1981 to 1990, when M&A transactions were rather rare, acquirers exhibit positive abnormal long-term returns compared to their German industry peers. Our findings are robust for various firm and deal characteristics and consistent with our analysis of pre and postmerger operational performance and announcement returns.

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1. Introduction

Since the 1980s, mergers and acquisitions (M&A) have attracted considerable interest in academic research. A bulk of empirical studies focuses on short-term stock returns near announcement days. Fewer but still many studies analyze the long-term performance of acquirers in the aftermarket from an investor's perspective and relate stock performance to deal and firm characteristics as well as to regulatory issues. Most of the studies analyze the U.S. market, but we also find studies for the U.K., Canada, and other markets. Although the studies vary greatly in design, datasets, etc., the overall picture indicates some long-term, postmerger acquirer underperformance. Many efforts have been spent on better measurement techniques, benchmark issues, and improved test statistics. Some more recent studies challenge the notion of long-term underperformance, which is inconsistent with the hypothesis of efficient markets[1].

The German market has been vastly ignored in this field of research. We were not able to identify any comprehensive, recent study that focused on M&A of German acquirers[2]. Our paper seeks to fill this gap. At first glance, this lack of research seems surprising given that Germany has been the third or fourth largest economy globally over the last three decades. We see two main reasons for this disregard. First, M&A played for decades a far less important role in the German economy than in the Anglo-Saxon world. A market for corporate control in the sense of Manne (1965) did not exist till the late 1990s, and although we observe an increase in the number

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[1] E.g., Dutta and Jog (2009) could not find a significant abnormal performance using a control firm approach and adjusted test statistics for a large sample of Canadian acquirers. We refrain from a general literature review that can be found elsewhere (e.g., Martynova & Renneboog, 2008) and instead discuss our findings in the context of previous literature.

[2] Campa and Hernando (2004), Croci (2007), and Martynova and Renneboog (2011) include M&A transactions of German firms in a European dataset but refrain from a country-specific analysis.

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and size of transactions since the 1990s, outright hostile takeovers are still very rare. Second, the necessary data, in particular less recent data, are not readily available.

In this paper, we empirically study long-term abnormal returns and the operating performance of German acquirers for a sample of 338 deals that were completed between 1981 and 2010. Over the three decades of our analysis, the German economy developed from an insider-controlled, bank-based system to a more capital-market-oriented system. We first briefly examine the institutional setting that led to the emergence of an active M&A market. In the empirical section, we also divide our sample into three subsamples (1981–1990, 1991–2000, and 2001–2010) to relate our findings to the different stages of the evolution of the M&A market.

The paper proceeds as follows: In Section 2, we briefly describe the evolution of the German system of corporate governance as well as the German capital market with regard to M&A transactions. In Section 3, we introduce our dataset and methods. Section 4 presents the results and discussions. Section 5 concludes.

2. Institutional background

The traditional German system of corporate governance has often been described as insider-controlled and stakeholder-oriented (Franks & Mayer, 1998). Looking back, it is often characterized as a consistent system of corporate governance with complementary features (Hackethal, Schmidt, & Tyrell, 2003): the management board of stock corporations is controlled by a supervisory board that represents the major stakeholder groups. The first group were often blockholders, either families or large banks and insurance firms that channelled savings to firms through direct investments[3]. Firms relied heavily on credit provided by their house banks, which often had a seat on the supervisory board and proxy voting power. Owing to mandatory labor codetermination, the third group on the supervisory board consists of employees, who are typically represented by trade unions. All three groups had a genuine interest in stability and long-term growth. The primary focus was not on maximizing (short-term) shareholder value[4]. Shonfield (1965) noted that this system of corporate governance in postwar Germany was not centrally planned but rather politically orchestrated. It also reflected a postwar settlement between capital and labor. Corporate governance relied heavily on internal information and control, not on the capital market. The large public firms were often interwoven through direct holdings, gross holdings, and pyramidal ownership structures, with the large banks and insurance firms in the center[5]. The weak role of the capital market in financing firms is best illustrated by the fact that the number of publicly listed corporations actually declined from approximately 630 in the early 1960s to 440 in the early 1980s.

It is not surprising that in such an insider-controlled and stakeholder-oriented economy, there was no active market for corporate control in the sense of Manne (1965)[6]. Legal protection of small or outsider shareholders was rather weak (La Porta, López de Silanes, Shleifer, & Vishny, 1997). In this consensus-oriented governance system, which is deeply interconnected with the concept of the social market economy, M&A activity ultimately required the approval of all stakeholder groups (Hackethal et al., 2003). In particular, employees could fear the breach of implicit contracts (Shleifer & Summers, 1988). Furthermore, high capital gains taxes on the sale of corporate cross holdings prevented efficient divestiture[7]. The high (by international standards) leverage of German corporations also reduced their ability to engage in levered transactions (Borio, 1990). Finally, managers had few direct incentives to maximize shareholder value[8]. Despite these obstacles, we observe some M&A activity, although large transactions were rather rare. We hypothesize that owing to the high threshold for engaging in M&A activity, transactions were undertaken only if they were economically very promising.

In the early 1990s, we observe a fundamental sea change in the German capital market and in M&A activity. Between 1990 and 2002, four Acts on the Promotion of Financial Markets were enacted. They were part of harmonization efforts within the European Union, where national regulations on corporate governance and financial markets varied widely. They also laid ground for upcoming privatizations. Concerning M&A transactions, the acts increased the transparency of shareholder structures[9]. Most notably, a Takeover Code became effective in 1995 that stipulated the conduct of the bidder and the target. In particular, it called for a mandatory tender offer to the remaining shareholders after an acquirer gained the majority of shares. It further demanded a neutral stance of the target. About two-thirds of the one hundred largest corporations signed the code.

It was also in the early 1990s that Anglo-Saxon investment banks set up offices in Frankfurt, offering new financing alternatives to the German corporate world. The development of investment banks changed the relation between traditional credit and commission-based businesses and led to an increase in M&A activity. Deutsche Bank made the strategic decision to enter the international investment banking arena. At the end of 1989, Deutsche Bank acquired Morgan Grenfell in the U.K. to gain access to the Anglo-Saxon banking culture and expertise. Dresdner Bank followed with the acquisition of Kleinwort Benson in 1995.

[3] Franks and Mayer (1998) report that in a sample of 171 large German corporations 85% of the firms had blockholders (holding >25% of the shares).

[4] The apparent lack of external control did not, however, impede economic growth. By the 1980s, Germany had become the world's third-largest economy. Deutsche Bank had the largest balance sheet worldwide at that time.

[5] A prominent example is the insurers Munich Re and Allianz, which each owned 25% of the other. Böhmer and Becht (2001) reported that two-thirds of all listed corporations in Germany had one blockholder with a share of 25% or above, which allowed vetoing important decisions.

[6] The first (and unsuccessful) hostile bid occurred in 1988 for Feldmühle Nobel AG.

[7] For an empirical examination of the economic magnitude of this effect at the time when the capital gains tax was repealed in the year 2000, see Edwards, Lang, Maydew, and Shackelford (2004).

[8] Stock option plans were in principle possible through the issuance of convertible bonds. We are not aware of a single example of a stock option plan intended to motivate managers before the 1990s.

[9] Insider trading became illegal in 1994.

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