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Partial-control versus full-control acquisitions: Does target corporate governance matter? Evidence from eight East and Southeast Asian countries☆

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ABSTRACT

In this paper, we expand the understanding of majority acquisitions from the target firm's perspective by testing whether target corporate governance mechanisms can explain the trade-off and outcomes between partial-control and full-control acquisitions across eight East and Southeast Asian countries. We find that bidders tend to prefer partial-control acquired targets with more independent directors, powerful CEOs, and higher block-shareholdings regardless of the target country's economic development level. These governance characteristics also lead to a lower likelihood of achieving actual equity acquisitions compared to unmatched ownership outcomes. Our results support the supply-oriented view that targets are generally reluctant to give up corporate control until the activation of a compulsory acquisition clause. Our findings are also robust to variations in the imposed acquisition threshold in each country.
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1. Introduction

After the 1997–1998 Asian financial crisis, a number of East and Southeast Asian countries have undertaken governance reforms to encourage corporate and financial restructuring, improve competitiveness, and facilitate more rapid and complete economic recovery (Claessens et al., 2000; Johnson et al., 2000; Kim and Lu, 2013). This study is aimed not to analyze the relationship between the changes in corporate governance practices and M&A activities. Instead, the focus of this study is on the relation among target corporate governance, ownership choices and takeover outcomes. Accordingly, we ask three questions: (1) What is the role of target corporate governance in the bidders' equity ownership choices? (2) What is the effect of target corporate governance on takeover outcomes? (3) What happens to target firms at the time of the acquisition announcement?

Our study differs from recent research in several important ways: first, we employ a partial-control and full-control ownership dichotomy, which can yield a better understanding of majority acquisitions. Given an opportunity to acquire another firm, the bidders have the choice of purchasing a minority (less than 50%), or a partial-control (more than 50% and less than 100%) or a full-control (100%) ownership level of the target through a merger. Prior studies indicate that the drivers can differ markedly

☆ The initial development of this research idea was positively guided by the "pitching template" created by Faff (2015a, 2015b). As background, refer to Appendix A61 ("mergers & acquisitions") in the online pitch library: http://www.business.uq.edu.au/supplementary-material-pitching-research".

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across different equity ownership levels (Maksimovic and Phillips, 2001; Fee and Thomas, 2004; Shahrur, 2005; Ouimet, 2013; Liao, 2014). Nevertheless, existing research commonly has only examined the motives for the trade-off between minority and majority (more than 50%) ownership of the target. Particularly, these studies assume that purchasing more than 50% ownership (for instance, 75%) will be similar to obtaining 100% ownership. In a similar vein, Kim (2012) argues that the complexities, risks, and expected synergies will be different between partial-control and full-control ownership. To date, little work has been done on what determines a partial-control stake in acquisitions. Our study fills this research gap.

Second, we examine whether target corporate governance can explain the drivers and outcomes of equity ownership decision. Acquisitions are a useful strategic decision for revising the effect of corporate governance because they are often associated with the agency conflicts between shareholders and managers. Much attention has been paid to the relation between the acquirer's corporate governance structure and motivations for the equity ownership choices (Roll, 1986; Datta et al., 2001; Harford and Li, 2007; Malmendier and Tate, 2008; Croci and Petmezas, 2015). However, what is less clear is whether there is any impact of target governance characteristics on the bidder's ownership decisions and how important these mechanisms play in shaping the takeover outcomes and the gains to target firms. This study will shed additional light on the impact of corporate governance on corporate strategic decisions in the context of acquisitions.

Third, this study focuses on one of the world's fastest growing takeover markets, East and Southeast Asia. There are two main reasons for using this sample to examine the research question. The first reason is that, following the 1997–1998 Asian financial crisis, the wave of acquisitions was triggered by essential policy changes. Changes in the regulatory and policy environment, such as the liberalization of foreign capital flows, economic freedom, privatization and the deregulation of various markets since 2000 have facilitated international production systems to expand (Kim and Lu, 2013). Consequently, the number and value of completed takeover deals have experienced a strong increase with an annual average increase of about 32% and 20%, respectively in the 2000–2013 period. The importance of East and Southeast Asia acquisition activities is exemplified by the increasing share in the number of worldwide transactions from 27.03% in 2000 to 46.28% in 2013 and in its value from 11.26% to 30.47%. These results exceed Europe and North America by sheer volume. Europe accounts for more global acquisition deals by value, but East and Southeast Asia is trending toward a stable, even upward movement at a time when two developed markets, Europe and North America, are decreasing. Further, according to Claessens et al. (2000); Chen et al. (2009); Globerman et al. (2011); Claessens and Yurtoglu (2013), and Lebedev et al. (2015), the diversities in institutional environments and corporate governance practices make East and Southeast Asian countries differ significantly from each other and from the developed world as well (also see Table B.1 in Appendix B).[1] Given these diversities, they suggest that much attention should be paid to firm-level corporate governance mechanisms as they can provide a better opportunity for access to financing, valuation, and performance.

Based on the extant literature on corporate governance, we identify three different dimensions of target corporate governance: board independence; CEO power; and large shareholders. Regarding board independence, we find that bidders tend to prefer partial-control targets which have more independent directors at the time of takeovers. This finding expands prior empirical studies by Kini et al. (1995); Cotter et al. (1997); and Bange and Mazzeo (2004) regarding the effect of target board independence on the bidders' takeover choices and takeover outcomes. In terms of target CEO power, we find a positive correlation between target CEO power and partial-control ownership propensity, supporting our prediction that target CEO power is a significant predictor of the equity ownership decisions in takeovers. This finding enhances the empirical studies of the relation between majority acquisitions and target CEO incentives (Allen and Phillips, 2000; Fee et al., 2006; Ouimet, 2013). Finally, we find a strong positive relationship between target blockholdings and the likelihood of a partial-control ownership sought, consistent with the idea that bidders tend to select a partial-control rather than full-control when target firms have higher blockholdings. This result contributes to our current knowledge regarding the role of target large shareholder in controlling the takeover process (Gaspar et al., 2005; Greenwood and Schor, 2009; Cooney et al., 2009). On the other hand, we find that these above governance characteristics can result in a lower likelihood of achieving actual equity acquisitions relative to unmatched ownership outcomes regardless of the target country's economic development level. Some robustness tests are also employed to measure variations in the imposed acquisition threshold in each country. Overall, our findings are in line with the supply-oriented view that target companies are not willing to give up control and other benefits until they are required to follow the activation of a compulsory acquisition provision (Rossi and Volpin, 2004; Kim, 2012).

In terms of the target firm gains, our results are consistent with the existing literature which shows that target firms, as compared to bidders, tend to gain higher returns around the announcement date regardless of the achieved equity ownership levels. Further, we find no evidence that full-acquired target shareholders experience higher returns than partial control-acquired target shareholders. This suggests that the majority of acquisition gains are derived from achieving control outcomes, rather than from necessarily delisting acquired target firms.

The rest of the paper is organized as follows. Section 2 presents a detailed review of the existing literature, along with the objectives of this paper. The related hypotheses are also developed in this section. A description of data is given in Section 3, while Section 4 presents methodologies used to examine the research questions. Section 5 reports our empirical results, and Section 6 concludes the paper.

[1] Indeed, Table B.1 shows that the degree of shareholder protection is different among eight East and Southeast Asian countries, and from the developed world, such as the U.S and U.K.

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