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Analyst coverage of acquiring firms and value creation in cross-border acquisitions[☆]

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ABSTRACT

We analyze cross-border acquisitions (CBAs) in the context of growth options by investigating the shareholder wealth effects of acquirers and targets and changes in financial analysts' earnings forecasts for acquiring firms announcing CBAs. Our sample of 16,435 global CBAs over the 1984–2008 period is conditional on acquirers being followed by financial analysts. We find that for developed country acquirers with developed country targets, there is a statistically significant positive announcement CAR for acquirer firms, for the combined (acquirer and target) firms, and a significant post-CBA increase in the earnings forecast for the acquiring firms. However, the announcement CARs for developed country acquirers with developing country targets, and for developing country acquirers with targets in any country are not significant. In the analysis of earnings forecasts, we find that for all acquirers, the post-CBA median consensus earnings forecast is significantly higher than the pre-CBA forecast. Our results suggest that CBAs are a means by which acquirers exercise value creating growth options, but only in the case when developed country acquirers buy developed country targets.

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1. Introduction

A recent report by the United Nations Conference on Trade and Development (UNCTAD) indicates that cross-border mergers and acquisitions (CBAs) by transnational corporations had a total

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transaction value of \$339 billion in 2010, which represented an increase of 36% in comparison to 2009.¹ In recent years, there has been significant growth in CBA activity with targets located in developing countries that are experiencing rapid economic growth, such as Brazil, China, and India. There is also evidence of increased outward merger and acquisition (M&A) flows from developing countries. Some of the examples include the purchase of a significant stake in Repsol (Brazil) by China's Sinopec Group for \$7 billion in 2010 and the purchase of Corus Group (UK–Netherlands) by Tata Steel (India) for \$12 billion in 2007.

Academics have studied M&A activity in the US domestic market and international settings. The literature on the US domestic M&A research is voluminous (see, for example, Moeller et al., 2004; Devos et al., 2009). Extant empirical evidence regarding acquisition motives can be categorized into two broad themes: the first, which provides evidence that mergers are motivated by synergistic motives (for example, Jensen and Ruback, 1983; Devos et al., 2009), and second, the research that suggests that hubris, agency issues, and other motives influence decisions on US domestic acquisitions (for example, Roll, 1986; Malmendier and Tate, 2007). Some of the research methodologies in the aforementioned studies infer managerial acquisition motives by examining acquisition pricing. This approach potentially suffers from the researcher's inability to measure synergies directly, and consequently, the conclusion of "overpayment" in mergers can be a result of inability to account for synergies and/or correct characterization of acquisition motives.

M&A research that extends the analysis to CBAs has been growing (see, for example, Rossi and Volpin, 2004; Moeller and Schlingemann, 2005; Chari et al., 2009, 2010; Alexandris et al., 2010; Hope et al., 2011; Zhu et al., 2011). In the international context, managerial acquisition motives may not necessarily mirror domestic acquisition motives. The extant literature on acquisition motives in CBAs, as described in more detail in the literature review section, suggests that growth options may be a significant reason for CBAs. In cases where acquisitions were executed in order to capture new growth opportunities, one should observe, in addition to shareholder wealth effects, a significant increase in pre- versus post-CBA earnings estimates.²

In this paper, we examine whether acquirers use CBAs to internalize (or realize) growth opportunities, as suggested by media coverage and academic research.³ Myers (1977) suggests that when a firm undertakes an acquisition, it exercises a "growth option" by acquiring the target. Tong et al. (2008a) state that "growth options are important for strategy because they affect firms' incentives for making strategic investments and can affect the timing and structure of such investments, which in turn can impact firm's performance and competitiveness".

We study acquirer shareholder wealth effects and synergistic value creation (both acquirer and target) for a sample of global acquirers over the 1984–2008 period. Our analysis differs from prior research because in addition to investigating shareholder wealth effects, we investigate CBAs as growth options and analyze the change in financial analysts' earnings forecasts (pre- and post-CBA) for acquirers. If growth is a rationale for an acquirer in a CBA, we anticipate that the announcement of a CBA is likely to influence financial analysts' earnings forecasts of acquirer earnings. Our research objective of investigating the change in acquirer firm earnings forecasts dictates selecting only those CBAs where the acquirer has at least one financial analyst earnings forecast for the firm both pre- and post-CBA. Furthermore, prior research has found that the acquirer's country of origin (developed or developing) has

¹ See the *World Investment Report: 2011* published by UNCTAD. The CBA volume worldwide peaked at about \$1 trillion in 2007.

² We cannot rule out the possibility that executives of acquiring firms pursue CBAs for hubristic motives. However, in comparison to CBAs, domestic acquisitions are easier to execute and integrate with the acquirer's existing business (Chakrabarti et al., 2009), and it avoids regulatory hurdles in foreign countries. Thus, we posit that executives seeking to satiate hubristic impulses are likely to find domestic acquisitions a more attractive opportunity. While it is possible for executives to seek a hubristically motivated CBA of a target firm, it appears to be less plausible when compared to a hubristically motivated domestic acquisition.

³ Some representative media articles that suggest acquisitions are motivated by growth opportunities include 'Deals Surge 41% as Companies Chase Growth', *Wall Street Journal*, May 6, 2011, which discusses M&A activity of US firms, and 'Starbucks Annual Meeting to Focus on Growth' *MarketWatch.com*, March 21, 2012, where the company is "focusing on international expansion and new products". The *Wall St. Journal*, May 17, 2012 reports on the acquisition of Decision Resources Group by Piramal Healthcare Ltd. for \$635 million – "The deal is the latest sign that Indian companies are keen to pursue growth abroad ...". Another example is the news article 'Chinese Companies Embark on Shopping Spree in Europe', *Wall Street Journal*, June 7, 2011.

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