



Privatization decisions of Australian firms: An empirical investigation

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ABSTRACT

This study revisits the determinants of Australian public firms that choose to go private. The new determinants hypothesized in this study – the presence of financial crises, stock salience and excessive foreign operations – are found to be crucial to a firm's decision to go private. While these determinants are found to be present at the time of the Initial Public Offering (IPO), it still takes an average of thirteen and a half years post-IPO for a public firm to back to being private.

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1. Introduction

The economic differences between public and private firms were first recognised by [Berle and Means \(1932\)](#). Yet in the 85 years since, it is surprising how little research has been conducted in the space of private and public firms with respect to firms opting to go private, which is mainly due to a lack of data availability. The few studies that have been conducted have predominantly focused on U.S. firms (see [Mortal and Reisel \(2013\)](#) for a comprehensive list of research undertaken in the U.S.). As such, the scant existing literature is not entirely relevant for managers, investors and regulators in other countries where firms operate under vastly different market size, structures and breadth, institutional settings, tax and legal regimes; making it inappropriate to generalise from findings across countries. For instance, Australia varies from the rest of the world in many dimensions yet the only study ([Eddey et al., 1996](#)) that examines Australian firms' public to private transactions is conducted based on just four years of data and with a narrow research focus. Furthermore, in the 20 years since Eddey's study, increased private equity investment, globalization and a shift towards a more business-friendly regulatory and tax system are just some of the key aspects of the modern Australian financial market landscape.

Taking into account the various structural changes that now define the Australian economy, this study is the first to examine three new aspects of a firm's operation – the presence of financial crises, the firm's stock salience and international involvement – all of which are new to the literature. In addition, this study also employs previously identified determinants in a bid to test the literature's application beyond a U.S. context. Given that the number of firms going private¹ has increased considerably in Australia ([Newell, 2006](#)), Australia serves as a good candidate for such a study. In fact, as alluded to before the leap to privatization has emerged as a new and important corporate restructuring mechanism under the new regime for private equity (introduced in 2002) to encourage foreign capital inflow in Australia ([Reserve Bank of Australia, 2007](#)), evidenced by the increase of private eq-

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¹ The terms private firms and private equity are used interchangeably.

uity transactions from A\$7 billion in 2006 to A\$46 billion (excluding Japan), mostly driven by billion-dollar investments in Australia and China. Australian transactions accounted for A\$11.7 billion of this,² indicating strong growth in the private equity market in Australia.³

Why do firms decide to go private? There are several schools of thought suggesting that going private increases firm value and reduces wastage of firm resources over the long term. Remaining public can be costly – take for example the listing and reporting costs documented by DeAngelo and DeAngelo (1987); the lack of tax advantage (Kaplan, 1989); increased agency conflict due to widespread shareholdings (DeAngelo et al., 1984a, 1984b); agency costs of free cash flow between shareholders and management (Opler and Titman, 1993); and the high transaction costs in raising capital (Kim and Weisbach, 2008). Proponents of these theories opine that firm value may increase faster by saving on these costs of being a public company. Booth (1998) documents that greater efficiency helps to increase firm value and can consequently increase the value of shareholder wealth. If a set of firm characteristics can be identified to correctly indicate the chances of going private at an early stage, this information could help corporate managers and shareholders to decide whether to remain public or not. Despite the importance of identifying such characteristics and the growing prevalence of Australian private equity transactions, Australian evidence is scant. The only published Australian study that investigates the motivation of Australian firms going private (Eddey et al., 1996), focuses on the period immediately following the relaxation of anti-takeover provisions for Australian firms beginning to make the switch to private. As a result of this narrow focus, their results have limited application in a contemporary setting. As such, we are long overdue an Australian study that investigates the determinants of firms going private.

This study complements and expands on previous studies (Wright et al., 2000; Jackowicz and Kowalewski, 2006; Renneboog et al., 2007; Bharath and Dittmar, 2010; Goyal et al., 2011; Starks and Wei, 2013; Steijversa and Niskanen, 2013; Akhtar, 2014; Akhtar, 2015) of firms choosing to go from public to private by considering a broader set of determinants that includes three newly developed determinants (financial crisis, firm salience, and international involvement) in an Australian empirical setting over 26 years of data, representing the longest data-set ever used in Australia.

The results indicate that our three newly developed determinants – financial crises, firm salience, and excess involvement in foreign countries – are highly important in privatization decisions. These determining factors are in fact present at the time of the IPO, even though it takes an average of about thirteen and a half years after the IPO for a firm to go private. Firms that are in the insurance, real estate and banking sectors appear to engage more frequently in privatization-type mechanisms for corporate restructuring. Results also show that throughout a rolling window of 10 years, the majority of the determining factors remain similar across time.

This paper is organized as follows: Section 2 provides an overview of the relevant literature and hypothesis; Section 3 presents the sample selection, lists the data sources and presents the model; Section 4 conducts the analysis and discusses the results from the regression models and the robustness checks before concluding in Section 5.

2. Literature and Hypothesis

The literature on public firms going private dates back to the early 80s (DeAngelo et al., 1984a, 1984b) however to date, only a small number of studies have investigated the financial reasoning behind U.S. firms opting out from being publicly listed. Unsurprisingly, this has left a sizable gap in the literature regarding firm operating characteristics that influence privatization decisions, even more so taking into account the influence that globalization may have with regards to privatization which led to the development of our three unique determinants: firm international involvement, stock salience and financial crises. In particular, I consider that the international involvement of a firm is paramount given the rise of globalization in the 21st century; relatively easier access to technology means that firms are now increasingly operating in an international environment. A higher level of engagement in the international arena as well as greater information flow between international markets also contributes towards a firm's salience (or visibility) in an investor's mind. This study considers how these two aspects interact with a financial crisis situation in an attempt to capture the one-off, “unique” effects that an exogenous shock (such as a crisis) often bring about on a firm's operating and financial situation. When a firm has widespread international involvement and is relatively visible in investors' minds, then it is more than likely that the impact of a financial crisis would be twofold: firstly at a domestic level (e.g. where the parent company is headquartered) and secondly at an international level through its international subsidiaries.

Wier et al. (2015) find that firms that go private show improvement in liquidity and working capital, mainly driven by performance improvements. The paper claims support for Jensen's hypothesis that going private creates organizational structures that reduces agency costs (and this should hold for both a management buyout or buy in). Accordingly, the implied motivation here for going private is to reduce firm mismanagement. Following this line of argument, I argue that the effects of firm mismanagement may become more visible during a financial crisis when firms become more resource constrained, as any deficiencies arising from mismanagement are less likely to be cushioned by positive performance from an overall environment of strong economic growth. As such, during a crisis, there are greater opportunities for a private buyout for firms in distress which may be due in part to mismanagement. Mismanagement is also more likely to occur in less salient firms. Highly salient firms often allow shareholders to better track managerial decision-making and performance. This greater level of scrutiny reduces the agency

² http://www.metrics2.com/blog/2006/12/13/asia_pacific_private_equity_deals_tripled_in_2006.html and Reserve Bank of Australia (2007).

³ Further, it has been reported that in recent years the M&A activity in the Asia Pacific region is positive and shows resilience during the Global Financial Crisis. This is especially boosted by several large deals in Australia, China and Japan (e.g. total deal value increased to US\$421.4 billion in 2010 which is a 5% increase relative to 2009).

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