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The performance of frequent acquirers: Evidence from emerging markets ☆

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ABSTRACT

This study examines the returns to 2340 merger deals conducted by 1122 frequent acquirers in 17 emerging markets, during the period 1985 to June 2008. Our primary findings are as follows. Serial acquirers in emerging countries on average experience a declining pattern in returns with subsequent deals, but the pattern is not strong. However, conditional on successful initial deals, the declining pattern is strong for the majority of countries, is large in terms of the magnitude, and is significant in the multivariate regression analysis. We interpret the results as somewhat supportive of the hubris behavior as a factor in serial acquisitions (Roll, J Business 59, 1986). We also find a stronger declining pattern for more developed markets but no substantial difference between civil and common-law countries; the former might be explained by generally greater and increasing competition for control in more developed markets.

1. Introduction

The performance of frequent acquirers has been a well-researched subject, which is not surprising given that their performances have important implications for managerial ability and behavioral tendency. It is noteworthy that many studies find that returns to acquiring firms decline as these firms buy more targets; these studies include Fuller, Netter, and Stegemoller (2002), Guest, Cosh, Hughes, and Conn (2004), Aktas, de Bodt, and Roll (2007), Doukas and Petmezas (2007), Ahern (2008), Billett and Qian (2008), Ismail (2008), and Croci and Petmezas (2009). Most of these studies point out that this declining return pattern, especially when the first acquisition was successful, can be consistent with the hubris hypothesis first proposed

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by Roll (1986): Roll hypothesizes that over-confident or over-optimistic managers might tend to pay too much for targets. Malmendier and Tate (2008) also argue that the existence of over-confident managers can lead to bad acquisitions. If managers gain more confidence after early successful acquisitions, it could explain the declining pattern in returns to acquirers. However, some of these studies such as Guest et al. (2004) and Aktas et al. (2007) point out other factors that can also account for a declining pattern in returns; for example, the declining pattern might be explained by a diminishing pool of good targets, costs of integrating targets, and learning effects.

All of the above studies examine either the United States or United Kingdom merger markets. This paper extends the literature by analyzing frequent acquirers in emerging markets. Analyzing frequent acquirers in emerging markets can provide additional insights for several reasons. First, country factors might affect merger decisions to a greater degree in emerging markets. In a study of factors influencing corporate governance across countries, Doidge, Karolyi, and Stulz (2007) compare the relative importance of firm characteristics and country characteristics, with the latter including legal protections for minority investors and the level of economic and financial development. They find that country factors are very important, especially for emerging markets. They state that "we show that firm characteristics explain almost none of the variation in governance ratings in less-developed countries…" Since merger decisions are affected by corporate governance, their finding suggests that country characteristics may also play a very important role in merger decisions in emerging markets. Moreover, several cross-country studies find that mergers[1] are affected by country factors such as investor protection (Boubakri, Dionne, & Thouraya, 2008; Rossi & Volpin, 2004), competition for corporate control (Alexandridis, Petmezas, & Travlos, 2010), and the extent of market development (Croci & Petmezas, 2010). Consequently, we examine differences in reactions to serial acquisitions between countries practicing civil and common-law systems and between more and less developed markets.[2] Second, there are relatively more family or tightly controlled firms in emerging markets, so outside monitoring might be less effective[3]; if so, hubris-infected managers might be less disciplined. Stated differently, mergers affected by hubris may be more common in emerging markets, thereby suitable to test the hubris hypothesis. Third, firms in emerging markets make acquisitions less frequently than those in the U.S. and U.K., so complicating factors such as learning and diminishing targets might be of less influence here.[4] Finally, capital markets in emerging countries are generally characterized by high information asymmetry[5] (Bhattacharya & Daouk, 2002; Jin & Myers, 2006), market illiquidity (Lesmond, 2005), and poor investor protection (Djankov, La Porta, Lopez-de-Silanes, & Shleifer, 2008; Dyck & Zingales, 2004). These may alter the documented performance pattern for repeat acquirers, so it is worthwhile to examine whether declining returns also hold in emerging markets.

An additional reason for taking up the issue is the recent phenomenal growth in mergers and acquisitions (M&As) in emerging markets. It appears that market liberalization of many emerging countries has provided incentives for firms to become more engaged in acquisitions. Recent data from Securities Data Company's (SDC) World-Wide M&As data base indicates that the acquisitions undertaken by firms from emerging countries have become more intense. The total value of M&A transactions increased from $10.47 billion in 1990 (4% of total value of world M&A transactions) to $189.8 billion in 2007 (11% of total value of world M&A transactions), a 17-fold increase during the period of 1990–2007. Additionally, Flanagan, Milman, and D'Mello (1997) show that M&As activity in Latin America by local and international acquirers increased tenfold between 1984 through 1994 due to the introduction of new economic and investment policies in these markets.

In sum, major objectives of this study are 1) to examine deal characteristics and the market reaction to frequent acquirers' merger announcements in emerging markets, and 2) to analyze whether cross-country variations in frequent acquirers' returns can be explained by differences in the legal systems and differences in the extents of market development. Countries practicing common law tend to be associated with a greater level of investor protection than those of civil law (La Porta, Lopez-De-Silanes, Shleifer, & Vishny, 1997, 1998, 2000). Markets with higher development tend to be associated with greater market

[1] These studies do not concentrate on frequent acquirers.
[2] We thank the reviewer for pointing out the potential importance of the extent of market development.
[3] This may be one reason that country factors explain more of corporate governance in emerging markets.
[4] Less frequent acquisitions in emerging markets may suggest fewer mergers affected by hubris. However, other factors such as differences in regulations and tax structures make cross-country comparison of merger frequencies less than clear.
[5] Information asymmetry in this context includes: insider trading regulations, financial disclosures, and domestic vs. foreign information advantages.