



Convergent synergies in the global market for corporate control

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ABSTRACT

We investigate the informational role of the takeover premium as a forward looking price to expected synergies in the global market for corporate control. We find that premiums paid in the global market for corporate control are clustered in waves and driven to some extent by the US premium. International takeover premiums have become more responsive to US premiums as the globalization process evolved over time. Short-run divergent dynamics due to idiosyncratic or country-specific factors have become less severe, which suggests that expected synergies have become increasingly integrated in the global market for corporate control. Furthermore, we find that the region's takeover premiums typically become more responsive to US takeover premiums when US economic conditions are relatively weak, when the US monetary policy is restrictive, when US credit risk is high, and when the region's corporate governance (as measured by legal system quality and accounting quality) is high.

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1. Introduction

In the market for corporate control, firms typically must pay a large premium in order to achieve control of a public target company. The premium to be offered by the bidder may be conditioned on several firm-specific factors, such as the use of cash versus stock (Kaufman, 1988), the amount of cash available to the bidder (Harford, 1999), the degree of deal hostility (Schwert, 2000), the target's board composition (Bange and Mazzeo, 2004), the resistance of the target (Jennings and Mazzeo, 1993; Khanna, 1997), and the bidder's prevailing valuation (Dong et al., 2006). In addition, merger premiums may also be affected by exogenous factors such as economic, regulatory, and technology shocks (Harford, 2005), the country's corporate governance regime (Rossi and Volpin, 2004), the country's stock market development (Crocchi and Petmezas, 2010), or endogenous strategic factors such as competition among prospective bidders (Asquith, 1983; Toxvaerd, 2008).

In a competitive market for corporate control with incomplete information about the underlying fundamental value of the resulting company, the takeover premium may serve as a proxy for the expected synergy of the merger and acquisition (M&A) process. Madura and Ngo (2008) show that takeover premiums in the US cluster over time. Moreover, other bidders' decisions to bid

constitute an information externality that improve the information of the next prospective bidder (triggering effect). This information pushes takeover premiums higher ex post, leading to informationally efficient clustering. However, rising premiums might deter disciplinary acquisitions in the market for corporate control, dampening real economic efficiency and increasing the value of the bidder's option to delay the bid, pushing downward takeover premiums (anticipation effect). Shleifer and Vishny (2003), Rhodes-Kropf et al. (2005), Toxvaerd (2008), and Edmans et al. (2009) document how valuations and merger activity are related. Yet, less attention has been given to the dynamic behavior of takeover premiums between the US and the rest of the world (ROW) in the market for corporate control.

In the current interdependent world economy, each industry is composed of firms from many countries that make up the global market share, and consequently exogenous shocks in the industry of one country should be transmitted horizontally and/or vertically to industries in other countries. In this respect, Dées and Saint-Guilhem (2009) using a vector autoregression (VAR) model of the global economy provide evidence of time-varying but significant real spillover effects from the US real business cycle to the rest of the world economy.

Furthermore, financial spillover effects might rise as a result of policy shocks, portfolio reallocations between countries of financial institutions with global presence, and changes in corporate governance standards across countries. In particular, since the early 1990s the equity markets have become increasingly integrated

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through the cross-listing of stocks with main trade center in New York City. This cross-listing process boosted the number of cross-border takeovers financed with equity due to lower transaction costs (Burns, 2007), bonded the non-US corporate environment to the US regulatory regime (Stulz, 1999), and facilitates desired changes in ownership (Ayyagari and Doidge, 2010). Investment banks became carriers of information from the center to the periphery bonding the ROW capital markets to the US capital market (Calvo, 1999).¹

To the extent that expected synergies are triggered by shocks that are correlated among countries, takeover premiums should be correlated among countries. Even if some expected synergies are imaginary rather than real because of overconfidence of managers, expected synergies may be correlated if managerial hubris (Roll, 1986) is correlated among countries.

Consequently, our main hypothesis is that takeover premiums in the global market for corporate control should be clustered in waves and driven by US takeover premiums. A first step in testing this hypothesis is to assess the degree of convergence of expected synergies across the world in the long-run through the joint dynamic behavior of takeover premiums internationally. Technically, we model the rest of the world (ROW) premium as a non-linear time-varying stochastic process with a common factor and a time-varying idiosyncratic factor loading coefficient. This modeling strategy introduced by Phillips and Sul (2007) is flexible enough to allow for transitionally divergent idiosyncratic behavior in integrated micro panels with significant data limitations. In this case, the use of standard econometric techniques like cointegration is not possible.

In the second part of the analysis we explore the economic and institutional factors that shape the observed time-varying path of integration in the global market for corporate control. For this purpose, we follow the methodological approach in Bekaert and Harvey (1995) and disentangle the ROW premium as a regime-switching process that transits between a regime where takeover premiums co-move together and a regime where they diverge driven by idiosyncratic factors. We find that the region's takeover premiums are commonly more responsive to US takeover premiums when US economic conditions are relatively weak, when the US monetary policy is restrictive, when US credit risk is high, and when the region's corporate governance (as measured by legal system quality and accounting quality) is high.

Overall, our empirical results show that although international takeover premiums may diverge in the short-run due to idiosyncratic factors, they tend to co-move in the long-run with Granger causality going from the US to the rest of the world. The empirical results are economically significant, as they are consistent with the broad financial and economic literature that stresses the role of forward looking prices, herding, and informational cascades in the transmission of information about value in sequential markets with partially incomplete information and learning (Chamley and Gale, 1994; Gul and Lundholm, 1995). In particular, the empirical results contribute to the M&A literature that explains merging activity as an endogenous process driven by real economic activity, market mis-valuations (Shleifer and Vishny, 2003; Rhodes-Kropf et al., 2005; Toxvaerd, 2008; Edmans et al., 2009), and institutional factors. Finally, our results suggest that besides the transmission of

corporate governance standards (Rossi and Volpin, 2004), cross-border bids play also an important role in the transmission of expected synergies in the global financial markets as ex post takeover premiums are asymptotically integrated.

The rest of the paper is organized as follows. Section 2 describes the data. Section 3 provides the static and dynamic analyses of the determinants of the ROW takeover premium. In Section 4 we provide a formal test of international convergence in takeover premiums and assess the relevance of economic and institutional factors in shaping the time-varying path of integration. Section 5 offers conclusions.

2. Data

Our sample includes all cross-border mergers and acquisitions of majority interest from January 1986 to December 2007. We only include in the final sample completed deals for which the deal value is available and the premium is within the range of 0–100%. Both the targets and acquirers in the final sample are publicly-traded firms. We exclude all financial (SIC code 6000–6999) and utilities (SIC code 4000–4949) firms from the sample as both sectors are highly regulated. Our final sample includes 1741 cross-border mergers and acquisitions.

The summary statistics for the sample of 1741 completed cross-border mergers and acquisitions are provided in Table 1. Panel A provides the sample distribution by year. More cross-border deals are observed in the periods of 1998–2001 and 2005–2007. Fifty-nine percent of the sample are mergers by firms in related business (as defined by the same 4-digit SIC codes), while 56% of the mergers are financed with cash only. Only 4% of the sample includes mergers with multiple bidders. Some characteristics of the mergers are provided in Panel B. On average, the deal value exceeds the target market value on the day prior to the announcement date by 33.59% (the median premium is 27.25%). The average deal value is \$1397.56 million while the median deal value is about one-fifth of the average. The average acquirer market value is about 30 times larger than that of the target while the median acquirer market value is about twenty times larger than the target market value. Panel C provides the distribution of cross-border mergers by the acquirer country and the target country. Mergers and acquisitions by US acquirers account for a substantial portion of the reported mergers.

3. Empirical analyses of the international takeover premium

3.1. The static model

We start out with a static analysis of the expected takeover premium. We apply OLS regression analyses to examine the factors that may drive international takeover premiums. Our main focus here is on whether the takeover premium paid in a cross-border merger is related to the mean premium paid for recent mergers in the domestic or foreign countries (including the US), while controlling for other factors. Our dependent variable is the premium paid for the target in each merger. The independent variables are:

RELATED = A dummy variable for deals by firms in the same 4-digit SIC codes. Flanagan and O'Shaughnessy (2003) argue that because mergers by firms in the same industry are more likely to create value from the resulting synergy, the bidders are willing to pay higher premiums for targets in a related industry.

TENDER = A dummy variable for tender offers. Madura and Ngo (2008) show that the premium paid for targets in merger transactions may differ from the premium paid for targets when using the tender offer process.

¹ During the 1990s for example, the Bank of New York alone had a market share in the American Depository Receipt (ADR) market of more than 50%. During the same period, US accounting GAAP standards and shareholder protection rules considered of comparable if not better quality than the International Accounting Standards (IAS), constituted the de facto worldwide benchmark for corporate governance. Despite the loss of popularity of the ADR program after the Sarbanes-Oxley act of 2002, still in 2006 two-thirds of the trading activity in depository receipts (including global depository receipts GDRs) was located in the NYSE.

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