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# Partial acquisitions, the acquisition probability hypothesis, and the abnormal returns to partial targets

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**Abstract**

The acquisition of a partial stake in a target firm has been positively linked to the likelihood that the target will be involved in a follow on full acquisition involving either the original bidder or a third party bidder. Existing studies provide only suggestive evidence of this linkage by comparing the abnormal returns to partial targets that are ultimately acquired to those that are not. Using a sample of partial acquisitions, we identify characteristics that impact the probability of a full acquisition and provide a tangible link between partial target gains and the ex ante probability of acquisition. Partial targets experience positive announcement effects, and the gains are greater for subsequently acquired targets. Partial bids initiated by corporate bidders are more likely to result in a full acquisition, and the size of the acquired stake and the level of institutional ownership are positively linked to the probability of acquisition. Further, the partial target gains are positively linked to the ex ante probability of acquisition even after controlling for any increased monitoring and discipline that the partial bidder is expected to impose. The findings are robust across various time horizons and model specifications.


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## 1. Introduction

There has been much discussion in the takeover literature of the benefits for bidders that take prior ownership positions in their targets. Beyond the substantial gains on the pre-bid ownership stake, partial prior ownership may benefit bidders if it helps to deter rival bidders (e.g., Stulz et al., 1990; Betton and Eckbo, 2000), alleviate the free-rider problem (e.g., Shleifer and Vishny, 1986; Hirshleifer and Titman, 1990; Chowdry and Jegadeesh, 1994), and decrease the likelihood of management resistance to a full takeover (Jennings and Mazzeo, 1993; Betton and Eckbo, 2000).

Further, studies show that establishing prior ownership increases the bidder's chance of a successful full acquisition.[1] Walkling (1985) finds that prior ownership is a significant factor explaining the probability of acquisition. Examining the role of the large shareholder in corporate governance, Shleifer and Vishny (1986) show that the probability of an acquisition increases as the proportion of shares owned by large shareholders increases. Hirshleifer and Titman (1990) develop a model that shows an increase in the probability of a successful tender offer when the bidder has a high prior ownership position. Choi (1991) reports that full takeovers are relatively more frequent among firms with prior ownership, compared to firms without prior ownership. Singh (1998) concludes that toeholds increase the probability of a full takeover and the price paid for the remaining shares, as long as the bidder does not withdraw the offer. The work by Bulow et al. (1999) indicates that a firm with a toehold is more likely to win a competitive takeover battle than a firm without a toehold. Using a sample of tender offers, Betton and Eckbo (2000) find that the probability of a successful single-bid takeover increases with the size of the prior ownership position. Indeed, Goldman and Qian (2005) develop their model on the assumption that the probability of acquisition is an increasing function of the size of prior ownership.[2]

Even though a partial position can give the bidder an advantage in subsequent takeovers, the evidence suggests that most partial bidders do not follow up with a full takeover of the partially acquired firm. Betton et al. (2005) report that only 4% of 10,000 toehold acquisitions led to a takeover attempt by the same bidder within a two-year period following the initial toehold. They argue that the costs of toeholds reduce the likelihood of a takeover attempt. In particular, approaching a target with a toehold may be perceived as an aggressive stance resulting in target resistance.

Nevertheless, there is evidence that toeholds are often followed by outright acquisitions by the original or third party bidders, which is also the focus of our study. Choi (1991)

[1] Despite this apparent advantage, bidders often do not establish pre-bid ownership in their targets (e.g., Bradley et al., 1988; Stulz et al., 1990; Jennings and Mazzeo, 1993; Betton and Eckbo, 2000). One explanation is that a value-maximizing bidder may simply want to avoid signaling its interest in the target. Other explanations include the possibility that bidders may overpay (Burkhart, 1995; Singh, 1998; Bulow et al., 1999) or fear a failed takeover attempt (Goldman and Qian, 2005).

[2] There is other suggestive evidence that acquisition probability is related to partial prior ownership in the studies by Mikkelson and Ruback (1985) and Barclay and Holderness (1991). They find that stock price run ups prior to takeover announcements may be influenced by partial prior ownership.