



Do joint ventures and strategic alliances create value for bondholders?



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ABSTRACT

This paper investigates whether joint ventures and strategic alliances create value for bondholders by examining the bond market's reaction to announcements of these two types of cooperative business activities. Based on 2964 announcements from 1985 to 2011, we find that joint ventures and strategic alliances create significant value for bondholders. The average two-month abnormal bond return is 0.64% for joint ventures and 0.70% for strategic alliances. We find no evidence of a wealth transfer between the bondholders and stockholders. We further explore the determinants of bond value creation through hypotheses on the synergy effect, the alleviation of financial constraints, and real options. The results of our study show that financial synergy is a main driver of bondholder wealth effects in joint ventures, while operating synergy is a dominant factor in strategic alliances. We also find evidence to support the real option hypothesis for both events. Finally, we show that the structure of bond contracts plays an important role in the link between synergy and abnormal bond returns.

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Dell Inc. unveiled an expanded global alliance with Oracle Corp. ... Marius Haas, president of enterprise solutions for Dell, said the alliance will help Dell “grow fast in the data-center and gain market share across the world in our three core businesses.” ... Oracle president Mark Hurd said this significantly expanded strategic partnership “is an extension of Oracle's engineered systems strategy where we simplify IT and reduce integration costs by delivering hardware and software together.”

[– Wall Street Journal, June 4, 2013]

1. Introduction

In the past few decades, business has been experiencing a wave of organizational restructuring. The extent of restructuring is seen not only in the equity redistribution of ownership, such as spin-offs, privatization, and mergers and acquisitions (M&A), but also in joint ventures (JV) and strategic alliances (SA). JV and SA have been recognized by CEOs to be as important as the financing and product markets. A survey by McKinsey shows that, between 1996 and 2001, about 57,000 alliances were formed, with a total

value of \$12 trillion.¹ As suggested by Harrigan (1985), the major difference among the cooperative strategies is the degree of equity ownership, ranging from full equity ownership via mergers and acquisitions to no new entity created or ownership shared in SA. The midrange of Harrigan's classification is characterized by partial ownership in JV. Gleason et al. (2003) refer to JV and SA collectively as cooperative activities, strategies, or agreements. A substantial body of research has documented the effects of these cooperative activities on value creation. Fee et al. (2006) show that minority acquisitions mitigate incomplete contracts and thereby facilitate cooperation between two independent firms. McConnell and Nantell (1985) and Johnson and Houston (2000) document positive stockholder wealth effects associated with JV announcements. Chan et al. (1997) find that SA create shareholder value.

The literature suggests that JV and SA improve operating performance or financial status through synergy and may help alleviate financial constraints for the participating firms. Based on the contingent claim theory, we conjecture that JV and SA offer participants a valuable real option in investment decisions. As bondholders represent one of the major claimholders, one would expect them to benefit from these value-creating events. Given

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¹ Chan et al. (1997) document that 63% of the fastest-growing U.S. companies participated or planned to participate in an alliance. Anand and Khanna (2000) report over 20,000 global alliance announcements in 1999 and 2000.

the extensive literature on the positive shareholder wealth effects, we find that the following research questions remain unexplored and are of great interest: (1) Do JV and SA create value for bondholders? (2) If so, what are the main determinants contributing to bondholder value creation? (3) Are the value drivers of JV and SA different? And (4) Is positive shareholder value creation from JV and SA detected in the existing literature the result of wealth transfer from bondholders? Investigation of the wealth effects of bondholders is critical for understanding documented value creation for shareholders and the overall impact on firm value. Recent studies on major corporate events suggest that the announcement effects are not limited to shareholder wealth but also include bondholder wealth (e.g., [Baran and King, 2010](#); [Billett et al., 2004](#); [Thompson and Apilado, 2009](#)).² In this study, we examine these questions by conducting a comprehensive examination of how JV and SA affect bondholder wealth.

Based on a sample of 2964 cooperative agreements, we find positive and significant bond price reactions to announcements, suggesting that JV and SA do increase bondholder wealth. In particular, the average bond abnormal return over a two-month window is 0.64% for JV and 0.70% for SA. We investigate several channels through which JV and SA can create value for bondholders and examine whether their value drivers differ. Using a sample of European and U.S. banks, [Amici et al. \(2013\)](#) find that the factors driving abnormal stock returns of JV and SA vary. Consistent with their finding, we show that the determinants of bondholder wealth effects of JV and SA differ. In particular, SA exhibit positive bondholder wealth effects through an increase in financial and operating capital cash flows, an expected increase in EPS, and shorter geographical distance. For JV, bondholder value is created through an increase in financial capital cash flows and an expected increase in EPS. Such a channel of value creation is categorized as the synergy effect, proposed by [Amici et al. \(2013\)](#), [Chan et al. \(1997\)](#), [Devos et al. \(2009\)](#), [Gleason et al. \(2003\)](#), [Johnson and Houston \(2000\)](#), and [McConnell and Nantell \(1985\)](#). In addition, industry competitiveness drives bondholder returns in SA, while industry competitiveness and the uncertainty of industry profitability lead to larger bondholder reactions in JV. These results support the real option hypothesis ([Kogut, 1991](#); [Mody, 1993](#)). Both JV and SA offer a real option through which firms can learn more about the parameters of technology and product markets before further investment is made. Real options are especially valuable when potential investments are in an industry with intense competition or significant uncertainty regarding profitability. Furthermore, we find little evidence that the alleviation of financial constraints benefits bondholders, while the literature suggests that it explains shareholder returns ([Boone and Ivanov, 2012](#)). Lastly, we find positive shareholder reactions, which are consistent with the current literature. Shareholder returns can be explained by the synergy, alleviation of financial constraints, and the real option hypotheses. By examining abnormal bond and stock returns, we find that the value created for shareholders is unlikely to be attributed to a wealth transfer from bondholders.

We further conduct the bond-level analyses to examine how the link between the synergy effect and bond value creation in JV and SA varies with convertibility, credit rating, and the priority structure represented by seniority, sinking-fund provision, and maturity. We focus on the effect of synergy on bondholder wealth because (1) we can further examine the effects of individual synergy components on bondholder returns and (2) synergy is one

of the main drivers of bondholder reactions. Based on the samples of 4519 JV and 6221 SA event-bond observations, we show that an increase in operating capital cash flows leads to positive and significant abnormal returns for convertible bonds, whereas an increase in financial capital cash flows results in a positive and significant reaction from non-convertible bondholders. In addition, we find that the synergy effect generates value for investment- and speculative-grade bonds, but the impact is significantly larger for speculative debt. Moreover, we show that bonds with a weak priority structure (i.e., unsecured or junior/subordinated bonds, bonds without a sinking-fund provision, and bonds with a longer maturity) gain more benefits from synergy. The results of the bond grouping analysis suggest that the impact of synergy on abnormal bond returns differs greatly by bond characteristics.

This study contributes to the existing literature in the following ways. First, our study is the first to examine the reaction of public bondholders to two types of cooperative activities, that is, JV and SA. We use a comprehensive sample consisting of deals across industries, countries, and a long sample period. In particular, we find economically and statistically significant abnormal returns, indicating that value is created for bondholders. Shareholders are found to benefit from JV and SA, but there is little evidence of a wealth transfer between shareholders and bondholders. Most of the existing studies examine shareholder returns for SA or JV, but not both. A few exceptions exist: [Amici et al. \(2013\)](#) distinguish JV from SA and examine shareholder wealth effects using a sample of banks. [Gleason et al. \(2003\)](#) analyze JV and SA, but do not report separate results. Second, we examine several hypotheses to explore the sources of benefits that contribute to bondholder wealth effects. We find support for synergy and real option explanations. We also note that the set of determinants for bondholder wealth effects on JV and SA differ. Finally, the bond-level analysis highlights the essential role in the bond structure on the link between synergy and bondholder wealth. We find novel results on how the relation between synergy and bondholder reaction varies by convertibility, credit rating, and priority structure specified by seniority, sinking-fund provision, and maturity.

The remainder of the paper is structured as follows. Section 2 proposes testable hypotheses. Section 3 describes the data sources, model specification, and variable construction. Section 4 discusses the empirical results. Section 5 is the conclusion.

2. Hypotheses development

Corporate consolidation and cooperative mechanisms can take many forms, ranging from simple agreements with no equity ties to more formal arrangements involving an independent new entity, equity ownership, and shared managerial control. [Chan et al. \(1997\)](#) indicate that strategic alliances involve two or more firms cooperating as partners in an arrangement through which firms share resources in production, marketing, distribution, or technology and thereby seek mutual benefit for all participants. This form of partnership has contractual agreements but does not involve equity infusion. By contrast, joint ventures are formed when partners create, with an infusion of equity, a new business entity specifically devoted to a common product or service. The existing literature suggests that cooperative activities lead to positive stockholder wealth effects, which are created through various channels (e.g., [Chan et al., 1997](#); [Johnson and Houston, 2000](#); [McConnell and Nantell, 1985](#)). To a greater extent, such major corporate events should also affect other claimholders. As major claimholders, bondholders should benefit from value-creating events, as shareholders do. On the other hand, bondholders may be concerned about wealth transfer to shareholders, given agency conflicts. As such, it is an empirical question to examine whether JV and SA can create value for bondholders in ways that are similar to

² [Thompson and Apilado \(2009\)](#) study carve-outs and find significant wealth effects for stocks and bonds. [Baran and King \(2010\)](#) find the same in going private transactions. [Billett et al. \(2004\)](#) focus on the effect of mergers and acquisitions on bondholders, but find no merger-induced wealth transfer between bondholders and stockholders.

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