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Real estate industry takeover bid patterns: Spain, a case study

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ABSTRACT

The upward of the Spanish real estate sector (2000–2007) caused the excessive growth of many companies mainly through acquisitions. This study aimed to identify behaviour patterns for takeover bids in the Spanish real estate industry, which was particularly hard hit by the last financial crisis. Considering that in bubble growing/burst periods, economic and financial variables are considered the most useful measures (market variables can have reliability problems), a set of 20 economic and financial variables was analysed, along with their relationship with listed companies' participation in this type of operations over the period 2000–2012. Both acquiring and target companies were included in the 354 cases studied here.

A two-stage methodology was used. Firstly, the principal component method was applied to identify the variables with greatest explanatory capacity. That was followed by the construction of a decision tree-based predictive model, more specifically a CHAID, which categorised the set of companies analysed to establish behaviour patterns.

The findings of this study show that the five principal components found to afford the greatest explanatory capacity were: (a) liquidity, solvency and borrowing capacity; (b) size; (c) economic performance; (d) operating capacity; and (e) financial performance. Taken together, the first two components explained 70% of dependent variable behaviour, primarily relative to buyers.

Overall, the model proposed explained on the order of 80% of dependent variable behaviour. The percentage not explained by the model was attributed essentially to strategic issues, financial speculation and private interests, among other factors present in decision-making.

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Patrón de comportamiento explicativo de las ofertas públicas de adquisición de acciones en el sector inmobiliario. El caso de España

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RESUMEN

La tendencia alcista del sector inmobiliario español (2000-2007) provocó el crecimiento excesivo de muchas empresas, principalmente mediante adquisiciones. Esta investigación pretende identificar patrones de comportamiento para la realización de OPAs en el sector inmobiliario español, particularmente castigado por la crisis financiera. Para ello, se ha analizado un conjunto de 20 variables económico-financieras y su relación con la participación de las compañías cotizadas del sector en este tipo de operaciones, para un total de 354 casos para el periodo 2000-2012, como adquirentes y adquiridas.

Para ello, se ha empleado una metodología en dos etapas. En primer lugar, se ha aplicado el Método de Componentes Principales para acotar las variables de estudio consideradas con mayor capacidad explicativa. En segundo lugar, se ha construido un modelo predictivo basado en árboles de decisión, concretamente de tipo CHAID, que permite categorizar el conjunto de empresas analizadas y discriminar patrones de comportamiento.

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Los cinco factores principales con mayor capacidad explicativa son: a) liquidez, solvencia y capacidad de endeudamiento; b) tamaño; c) resultado económico; d) capacidad operativa, y e) resultado financiero. De hecho, los dos primeros explican conjuntamente en torno al 70% de la variable dependiente, considerando principalmente a empresas adquirentes.

El modelo propuesto cuenta con un nivel de explicación global cercano al 80%. El porcentaje restante que no explica el modelo responde fundamentalmente a cuestiones de tipo estratégico, de especulación financiera e intereses particulares, entre otros factores que concurren en la toma de decisiones.

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Introduction

Since the onset of the international financial crisis, the convergence of the sovereign debt, banking and real estate crises in Spain has altered the former economic structure. With the collapse of prices, the Spanish property market, for decades the primary driver of national GDP and employment, has played a significant role in this process. The demanding provisions imposed by the Government on banks holding these assets has led to drastic adjustments in the industry, a rising flow of international investors seeking speedy returns and the sale of a number of financial institutions' real estate platforms.

These crisis-induced corrections reminded all Spanish industries and the real estate sector in particular of the existence of business cycles and the need to adopt measures in good years to ensure survival in unfavourable circumstances. Symptoms of better prospects for the country's real estate industry initially appearing in late 2014 have been consolidated in 2015 (KPMG, 2015, p. 8). The business opportunities that have begun to arise, particularly in cities such as Madrid and Barcelona (PWC, 2015, pp. 21 and 51), are visible in: the volume of assets sold by the Spanish "bad bank" or Sareb (Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria en España) and other financial institutions, with a growing number of interested buyers; the upturn in the number of leases, which enhances property values; and the heavy inflow of foreign investment (BME, 2015). Nonetheless, as Carbó and Rodríguez (2015, p. 22) observe, "risks persist, in light of high unemployment and the weakness of some European economies...". Malo de Molina (2015, p. 13) identifies additional risks, namely the high level of household debt and demographic factors that will affect demand in the long run.

Given the dependence of the number of acquisitions on factors such as market liquidity, affordability, interest rates and business prospects, industry recovery may be expected to induce further acquisitions. Modelling past behaviour is consequently useful for identifying the features of decisions that lead to better takeover results. The lessons learnt from the notorious errors committed in Spanish real estate majors' business plans (Martín, González, & Mendoza, 2011, pp. 244–245) must not be overlooked, however. During the years of economic expansion, size became a key variable to gain a competitive edge, prompting any number of concentration operations that restructured the business.

An analysis of the real estate industry revealed variability in the behaviour of its component businesses (Fig. 1). Whilst development exhibited essentially linear production (from land development to building sales), the real estate holding business followed a primarily recurrent pattern (with initially low asset turnover in the investment portfolio combined with real property rehabilitation and conservation, where appropriate).

For decades, real estate companies engaged in many such complex operations, most adopting the form of takeover bids. The proliferation of this type of operations also had knock-on effects for other industries and their entrepreneurial architecture, in which even production models and business plans were modified. The foregoing induced substantial legislative change in Spain, the most recent of which calls for a new takeover bid system designed to protect minority shareholders and encourage this type of operations. Both factors will be decisive for the industry.

The present paper analyses takeover bids in the Spanish real estate industry from 2000 to 2012. More specifically, it explores a total of 354 data items generated over the 13 years studied by 29 listed companies, divided into two major groups: companies participating in takeover bids (as buyers or sellers) and companies that did not engage in such operations (irrespective of their possible participation in other types of concentration, such as private mergers or acquisitions).

The research includes two aspects absent in prior papers on the subject. Firstly, the empirical analysis encompasses a very large number of economic and financial variables for all the companies analysed. Secondly, the model proposed is characterised by its ability to discriminate and categorise based on decision trees that define a characteristic behaviour pattern among companies involved in takeover bids.

The statistical study conducted drew from an exhaustive economic, financial and strategic analysis. The combination of these three analyses determined the factors or sets of variables with positive significance in takeover bidding. The resulting model will facilitate decision-making, the anticipation of possible operations and the prediction of the value of such operations on the grounds of the financial statements of the companies concerned.

The analysis is of current significance, given real estate companies' need to gain size through new national and international alliances and slacken the rigidities of the model that shackled the industry during the financial crisis.

Review of the literature

Since the beginning of the 20th century several waves of corporate M&As have led to significant industrial restructuring worldwide (Ahern & Harford, 2014; Alexandridis, Mavrovitis, & Travlos, 2011; Gugler, Mueller, Weichselbaumer, & Yurtoglu, 2012; Wang & Moini, 2012). Many studies have been published on significance of factors that may prompt business concentration. According to Farinós, Herrero, Latorre (2010, p. 7), "... the nature, objectives and expectations [of takeover bids] are issues to be borne in mind for they will condition the [company's] financial future, performance and results..." The most representative papers identify many reasons for engaging in takeover bids. Manne (1965) showed synergies and inefficient management to be the main reasons, to which Gaughan (2015) added a growth potential and tax issues. For Jensen and Ruback (1983), improved target company management is the key, whereas for Denis, Denis, and Yost (2002), the aim is to branch into new businesses or geographies in pursuit of growth. That concurs with Palepu's (1986) findings to the effect that the takeover of companies with low performance and prospects are used by high growth companies as an expansion tool.

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